The Law Commission

Working Paper No. 102

Landlord and Tenant: Compensation for Tenants' Improvements

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This Working Paper, completed on 12th March 1987, is circulated for comment and criticism only.

It does not represent the final views of the Law Commission.

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COMPENSATION FOR TENANTS' IMPROVEMENTS

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SUMMARY

In this working paper, the Law Commission examines, as part of its programme of modernisation and simplification of the law of landlord and tenant, the law relating to compensation for improvements made by tenants. The paper questions both whether the present scheme limited to business properties should be extended, and whether any compensation scheme is still needed. It then presents for consideration a number of individual reforms to the present scheme. Views are invited both from professional advisers concerned with property and from owners and tenants of business premises and other kinds of property.

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THE LAW COMMISSION

LANDLORD AND TENANT

COMPENSATION FOR TENANTS' IMPROVEMENTS

PART I

INTRODUCTION

1.1 A tenant's interest in a property demised to him is always for a limited period, and, when he is minded to improve the property, that necessarily creates a situation which can be seen as unfair and perhaps against the general public interest. The common law rule is that any improvements which the tenant makes - unless they take the form of fixtures, to which special rules apply - become part of the freehold property. Those improvements can range from relatively minor changes to the erection of complete buildings. When the lease ends, the tenant must hand the whole property, including the improvements, back to the landlord. He is not entitled to any compensation, and it makes no difference that he paid for the improvements, nor that the landlord knew of them and expressly gave his consent.

1.2 Two major criticisms can be levelled at that common law rule. First, when the landlord receives back the improved property he may often, although by no means always, re-let or sell the property at a rent or for a price which includes an element attributable to the improvement. In those cases, the

landlord makes an uncovenanted gain from the tenant's enterprise and expenditure. Secondly, it is in the general interest that properties be improved. Standards rise, and whether the improvements go to make industry more efficient and competitive, or residential premises more comfortable, it is desirable that these advances should be encouraged, or at least not discouraged.

1.3 These criticisms can be directly met by pointing out that the terms of leases are freely negotiated. Once they are fixed, they are known to the parties, and the general position about improvements is widely understood. Many tenants make an informed calculation about the value to them of possible improvements, bearing in mind the period of lease they have remaining, and decide that it is worth their while to spend the money. If there is an unexpected gain for the landlords in addition, the tenants have still obtained the benefit which they were expecting.

1.4 There have already been major statutory incursions into this free market. For lettings of agricultural holdings and business premises there are schemes allowing tenants to claim compensation in certain circumstances. We assume that these two types of property were singled out because it was seen to be desirable to encourage farming and other business enterprises carried on by tenants, and that the lack of the chance of compensation could inhibit them.

1.5 We should say at once that in this working paper we are not concerned with the compensation provisions of the agricultural holdings legislation.[1] It forms part of a complicated and integrated package of measures designed to balance the interests of landlords and tenants of farms. The Act regulates the basic obligations of the parties, gives security of tenure, lays down a rent-fixing procedure, and provides for compensation on a number of other grounds besides improvements to the property. We do not know of any fundamental disquiet about these arrangements, and it would clearly be wrong to disturb the balance by adjusting one relatively minor part of the scheme.

1.6 Putting agricultural holdings to one side, therefore, we are left with a startling contrast. In one major area in which leases are granted, business property, there is a compensation scheme. For all other property, there is nothing, even though an extension to residential property was recommended over thirty years ago. At least superficially, a single cohesive approach looks like an attractive reform of the law. If a tenant who spends money on his landlord's property deserves compensation, there may be no valid reason why residential tenants should not qualify. On the other hand, the present compensation scheme for business tenants can be criticised on two levels: fundamentally, it can be seen as no longer necessary; in detail, its procedure is cumbersome and some of its rules are unsatisfactory.

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[1] Now consolidated in the Agricultural Holdings 1986.

1.7 The circumstances in which leases are granted vary very considerably. Even if the conclusion is that there should be no statutory compensation scheme, that would not preclude the parties agreeing that there should be some payment. We can see no ground for banning such arrangements. Our examination is therefore confined to conferring general statutory rights. If such a scheme is to continue, it is necessary to consider whether, or to what extent, the parties should be able to vary or contract out of it in individual cases. That is a point to which we shall return.

1.8 Our purpose in this working paper is therefore to examine these questions:

(a) Should there be general statutory rights which entitle a tenant to compensation from his landlord for improvements which benefit the landlord?

(b) If so, should the range of tenants who benefit from the existing scheme be extended?

(c) If compensation should be continued but confined to business tenants, what changes, if any, are required to the present scheme?

Business premises

1.9 The purpose of the Landlord and Tenant Act 1927 as originally enacted was to remedy some of the recognised

disadvantages of the leasehold system in relation to business property. It gave tenants two statutory rights: first, to make certain improvements with the court's approval and despite the landlord's veto; secondly, at the end of tenancy, the tenant was either to receive compensation on quitting or to be granted a new tenancy at a rent which disregarded the value of the improvement.

1.10 The present statutory scheme works like this. A tenant of business premises proposing to make improvements must first serve a notice on his landlord, with detailed plans. Unless he does that, he can never be eligible to make a compensation claim, even if the terms of his lease allow him to make whatever improvements he likes. If the landlord objects to the proposal, the tenant must establish his eligibility by applying to the court for a certificate that the proposed improvement is a proper one. Tenants can also use this procedure to obtain authority for works which would otherwise be unlawful, e.g. where the proposed work would amount to breach of a lease covenant prohibiting alterations. The main grounds of objection available to the landlord are that the improvement would not add to the letting value at the termination of the tenancy, that other property of his would be adversely affected, and that he is willing to undertake the work himself in exchange for a reasonable rent increase. When the tenancy comes to an end, a tenant who has satisfied those preliminary requirements can make a claim for compensation, but no award will be made unless at that time the improvement contributes a net addition to the value of the premises to the

landlord. Nothing at all will be awarded if the landlord intends immediately to demolish the building or the improvement, or if the improvement has worn out, or its useful life has otherwise come to an end.

1.11 The importance of the compensation provisions was greatly diminished by the introduction, in 1954, of a new system of almost universal security of tenure for tenants occupying premises for business purposes.[2] Most are entitled to new leases at rents which disregard the effect of improvements for which they have paid. The position of business tenants is so much stronger now, quite apart from compensation provisions, that a tenant is much less likely to be forced to quit, leaving behind an improvement of value to the landlord. Another development which may have diminished the importance of compensation is that, with commercial premises, any refurbishments or other improvements tend now to be very much shorter lived.[3] Tenants will usually invest on the basis that improvements must easily pay for themselves within the term of the tenancy, so that even if there is a residual value remaining at the end of the contractual term, it is not such a glaring injustice that the improvement should be left behind benefiting the landlord.

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[2] Under Part II of the Landlord and Tenant Act 1954.

[3] See Depreciation of Commercial Property (Salway, Calus Research Report, 1986), a study in which modern depreciation in relation to office, retail and industrial property is examined.

1.12 We have made some preliminary enquiries to discover how far landlords and tenants were aware and made use of these statutory provisions, and whether there was any general dissatisfaction or particular criticisms levelled at the present system. A questionnaire was sent to over a hundred landlords, tenants and property advisers, and was summarised in the legal and property press. The seventy-three responses received cannot be taken as representative of the attitudes of all business tenants and their landlords, but have provided some very useful indications. It appears that many tenants are unaware of their compensation rights, which may often be lost either because the tenant has made the improvement without fulfilling the preliminary requirements and so could not claim on quitting, or because an eligible tenant has failed to make a proper claim within the time allowed at the end of the tenancy. There were criticisms that the Act is imprecise as to the formalities required, so that interested parties cannot be sure of the adequacy of steps taken. One possible result is that a landlord may not even be aware of the significance of an informal notice received from the tenant. Although it is clear that many landlords and tenants are ignorant of the provisions, or consider them unimportant, a substantial number regarded the statute as relevant. Parties may not necessarily make direct use of the statutory machinery, but their knowledge of it may influence their negotiations as to the effect of improvements. A significant proportion of the landlords who were aware of the provisions were confident that the terms of the leases they granted effectively avoided all risks of compensation being payable.

Less than twenty of those who responded had either served or received a notice under the Act within the last five years, and in only five cases had any compensation been paid for a tenant's improvement.

This working paper

1.13 In Part II of this paper we examine the law relating to compensation for business tenants' improvements, and other provisions which affect tenants who have made improvements or who wish to do so. In Part III we consider whether there is a need for a statutory compensation scheme, for residential property where no scheme applies now, and for business property, to which the present scheme applies. Part IV sets out criticisms of the present system and the aims of reform. A proposal for simplifying the scheme is put forward in Part V, and detailed proposals for reform are suggested in Part VI.

1.14 We are grateful for the help and advice which we have received, especially in relation to matters of valuation, from Mr. V.W. Taylor, LL.M., F.R.I.C.S.

PART II

THE PRESENT LAW

A COMPENSATION FOR BUSINESS TENANTS' IMPROVEMENTS

Outline of statutory provisions

2.1 Under section 1 of the Landlord and Tenant Act 1927, a business tenant is entitled to claim compensation for certain improvements made by him, or by his predecessors in title, which add to the letting value of the holding when his tenancy comes to an end and he leaves. The relevant provisions are contained in Part I of the 1927 Act, as modified by Part III of the Landlord and Tenant Act 1954.

2.2 The holding must have been used wholly or partly for carrying on a trade, business or profession.[1] The improvements which can be eligible for compensation are not expressly defined. They do include erection, demolition and rebuilding[2] of buildings, but cannot include trade or other fixtures which a tenant is entitled to remove.

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[1] S.17 provides that Part I applies to premises used for carrying out any trade or business and that premises used for carrying on a profession shall not be deemed to be premises used for carrying on a trade or business, but in relation to improvements premises regularly used for carrying on a profession are deemed to be used for a trade or business. The effect of these convoluted provisions is that premises used for carrying on a profession are included. The provisions were unfortunately not simplified when the sections dealing with other matters were repealed.

[2] National Electric Theatres Ltd. v. Hudgell [1939] Ch. 553.

2.3 Compensation is not payable until the tenant quits the holding at the termination of his tenancy, but he will not be eligible for an award then unless he has satisfied two sets of requirements, one relating to the time the work is proposed and the other to the end of the lease when the compensation is claimed. First, he[3] must have served on the landlord a formal notice of his intention to make improvements before starting work on them, and either have received no objection, or have obtained from the court a certificate that the improvement is a proper one. That certificate effectively overrides any objection by the landlord. Secondly, he must also have lodged his claim for compensation within the prescribed period at the end of his tenancy. The time depends on the manner in which the tenancy is terminated. The tenant can apply to the court for an award if his claim is not met by agreement.

2.4 The compensation payable is assessed by reference to the amount by which the improvement enhances the value of the holding to the landlord when it is returned to him. Thus the amount is reduced if the landlord's proposals for the future of the holding render the improvement less valuable.

Tenancies under which compensation can be payable

2.5 Part I of the Act applies to leases of any premises used partly or wholly for carrying on any trade, business or

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[3] Or his predecessor.

profession,[4] except:

(i) mining leases,

(ii) tenancies of agricultural holdings,

(iii) tenancies of premises used for the business of residential subletting, and

(iv) lettings made to tenants as the holders of any office, appointment or employment from their landlords and continuing while that position is held.

Business use

2.6 Where there is mixed user, (e.g. partly business and partly residential) the provisions apply only to improvements in relation to the trade or business.[5] There is no definition of a trade, business or profession[6] for the purposes of the 1927 Act. The wide definition of "business" in the 1954 Act, to include trade, profession, employment and any activity carried on by a body of persons,[7] does not apply. Again unlike the 1954 Act, tenancies of un-licensed premises are not

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[4] s. 17; see n.1 above.

[5] s. 17(4).

[6] Profit motive is not always an essential element, of trade see Brighton College v. Marriott [1925] 1 K.B. 312 (C.A.), affirmed [1926] A.C. 192, (H.L.).

[7] Landlord and Tenant Act 1954, s. 23(2).

excluded,[8] and there is no express provision to cover a case where the tenant's business user is in breach of covenant.[9]

Mining leases

2.7 Mining leases are outside the Act. The expression "mining lease" is defined to mean a lease for any mining purpose or purposes connected therewith, and "mining purposes" is widely defined.[10]

Agricultural holdings

2.8 An agricultural holding, within the Agricultural Holdings Act 1986, is also excluded. It is defined [11] as meaning land which is used for agriculture for the purposes of a trade or business, and which is comprised in the contract of tenancy.

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[8] Cf. Landlord and Tenant Act 1954, s. 43.

[9] Cf. Landlord and Tenant Act 1954, s. 23(4), which usually disqualifies business user in breach of a prohibition of use for business purposes.

[10] Landlord and Tenant Act 1927, s. 25.

[11] Agricultural Holdings Act 1986, s. 1. Agriculture is defined to include horticulture, fruit growing, seed growing, dairy farming and livestock breeding and keeping, the use of land as grazing land, meadow land, osier land, market gardens and nursery grounds, and the use of land for woodlands where that use is ancillary to the farming of land for other agricultural purposes, ibid., s. 96(i).

2.9 The exclusion of agricultural holdings gives rise to some anomalies, particularly where the land use is connected with horses, which are not normally within the definition of "livestock".[12] Land used for grazing horses in connection with a trade or business is an agricultural holding, and therefore excluded from the business tenancy provisions; if the grazing has no commercial context, there is neither agricultural holding nor business tenancy. Land used for horses otherwise than for grazing cannot normally be an agricultural holding, but if the use is part of a trade or business, the 1927 Act can apply.

2.10 There is some doubt whether a commercial farm letting for a fixed term of more than one but less than two years would fall under the business or agricultural improvement provisions. It has been held[13] that such a letting does not qualify for the agricultural security of tenure provisions. It has been suggested that therefore such a tenancy may not constitute a tenancy of an agricultural holding at all:[14] if that is right, the Landlord and Tenant Act 1927 applies.

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[12] Unless kept for the production of food, or skins, or for use in farming the land.

[13] Gladstone v. Bower [1960] 2 Q.B. 384, decided under the Agricultural Holdings Act 1948.

[14] See e.g. Scammell and Densham's Law of Agricultural Holdings 6th ed., (1978), p. 26.

What are improvements

2.11 The Act contains no definition of the term "improvements",. For the compensation provisions to apply, there must be some work done (or proposed) which adds to the letting value of the holding. Works enhancing the value or usefulness of the premises to the current tenant, and regarded by him as an improvement, do not necessarily qualify as an improvement for the purposes of Part I of the Act.

2.12 Trade or other fixtures which the tenant is by law entitled to remove, i.e. "tenant's fixtures" cannot qualify for compensation[15] whether or not they are actually removed. Erection and demolition of buildings or parts of buildings, and structural alterations are clearly included.[16] The statutory reference to a tenant making the improvement "on" his holding,[17] and recognition that "the works constituting the improvement"[18] may subsequently need repair suggests that the Act is concerned only with works producing some physical change in the premises.

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[15] Landlord and Tenant Act 1927, s. 1(1).

[16] National Electric Theatres Ltd., v. Hudgell [1939] Ch. 553.

[17] s. 1(1). "In Land Reclamation Co. Ltd. v. Basildon District Council [1979] 1 W.L.R. 767 Buckley L.J. considered it clear from the use of the words "at the premises" and "attached to the premises" in s. 5 (repealed in 1954) that the Act was relating to physical property - land or buildings - and not to incorporeal rights.

[18] s. 1(1)(b).

2.13 Despite the indications that only physical works are "improvements", a tenant may well undertake work which enhances the letting value without affecting the fabric of the premises, e.g. by securing more lucrative permitted user, better access rights over adjoining land, or covenants restricting local competition.[19] It may be argued that the mere use of terminology more appropriate to corporeal improvements cannot be sufficient to exclude other work by which a tenant has improved the letting value of the property. There is no authority on the point.

Improvements made by the tenant or his predecessors

2.14 To qualify for compensation, an improvement must be made by the tenant making the claim, or his predecessors in title, and not pursuant to a contractual obligation entered into for valuable consideration. A contract with a subtenant, or with a stranger, is sufficient to take the improvement outside the compensation provisions.[20] When the Act first came into force, no compensation was payable for improvements made in pursuance of statutory obligations, but that rule was one of those abolished by the 1954 Act.

2.15 The term "predecessors in title" has a rather wider

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[19] Subject to considerations of public policy which may limit the operation of covenants in restraint of trade.

[20] Owen Owen Estate Ltd. v. Livett [1956] Ch. 1.

meaning[21] than is usual in conveyancing law. The claimant does not have to have an identical title to the former tenant: his right to possession of the premises must simply be derived through that predecessor.[22]

2.16 An intermediate landlord receiving a claim can make a corresponding one against his own landlord.[23] So subtenants' claims are passed up the chain to the head landlord, provided that the necessary formalities are observed by all.

Date of improvement

2.17 The Act originally gave no compensation for improvements carried out during the last three years of the tenancy.[24] Landlords could also exclude a tenant's right to compensation by offering him a new lease - whether or not the

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21 s. 25.

22 Pelosi v. Newcastle Arms Brewery (Nottingham) Ltd. (1981) 43 P. & C.R. 18, where the claimant had acquired the interest of both a subtenant who had made an improvement, and the tenant who held the reversion to the sublease, and therefore was not entitled to exactly the same interest as the improving subtenant had been.

23 s. 25.

24 s. 2(1)(c), which by virtue of the Landlord and Tenant Act 1954, s. 48(2), does not apply to improvements begun after 1954.

offer was taken up.[25] These rules no longer apply.

2.18 There is some difference of opinion as to whether the compensation claim is limited to improvements carried out during the tenancy ending when the claim is made, or whether the claim can be carried over when a tenancy is renewed and made at the end of the new tenancy when the tenant quits.

2.19 The Jenkins Committee[26] expressed the firm view that a tenant's right to compensation for improvements could not survive a tenancy renewal, commenting:

> "Of course, if such an offer of renewal [under the provision then current] is made and accepted, the claim for compensation will disappear, as it will also do in the event of a renewal under the provisions [of Part II of the 1954 Act.] In either case, the tenant gets in lieu of compensation for his improvements a new lease at a rent which does not take them into account..."[27]

The House of Lords later held[28] that the rent under a new lease would leave out of account only those improvements made during the current tenancy. But in his dissenting judgment in the Court of Appeal, Lord Evershed M.R. drew attention to an anomaly which he said would result from the majority view, namely that a tenant who left at the end of a tenancy could claim for improvements made during previous tenancies, but if he stayed under a further renewal, such improvements would not be disregarded in fixing rent. His lordship had no doubt that the court's earlier decision in the context of compensation for goodwill "would have compelled a similar answer under

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[25] s. 2(1)(d); offers of renewal made after the commencement of the 1954 Act do not exclude compensation liability: s. 48(3).

[26] The Final Report of the Leasehold Committee (1950), Cmd. 7982.

[27] Ibid., para. 295.

[28] East Coast Amusement Co. Ltd. v. British Transport Board [1965] A.C. 58, on appeal from In re "Wonderland", Cleethorpes [1962] Ch. 696 (C.A.).

section 1"[29] so that a man could claim compensation for improvements made during a succession of tenancies. However, the rules about the impact of improvements on the rent payable under the new tenancy were later changed.

2.20 Perhaps improvements made during previous tenancies must be ignored because, unless the words "any improvement ... made by [a tenant] or his predecessors in title"[30] are read as being limited to improvements made during the current tenancy, it is difficult to see what title or capacity the tenant or "predecessor" must have enjoyed at the time of making the improvement. Although the expression "predecessor in title" has a special meaning[31] in this context, it can hardly be wide enough to cover all previous occupiers.

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[29] At p. 729. The majority view was that Lawrence v. Sinclair [1949] 2 K.B. 77 was an authority on a repealed section in a different Act in relation to a section in a different subject matter, and had no bearing upon the construction of s. 34(c) of the Act of 1954. Unlike Lord Evershed M.R., their lordships did not express any view as to whether Lawrence v. Sinclair would be compelling authority in relation to s. 1 of the Act of 1927.

[30] Landlord and Tenant Act 1927, s. 1(1).

[31] Pelosi v. Newcastle Arms Brewery (Nottingham) Ltd., 43 P. & C.R. 18.

Preliminary Requirements

2.21 There can be no compensation award at the end of the tenancy unless the tenant followed the procedure laid down by the statute before he made the improvement.

Notice of intention

2.22 To lay the foundations for a possible compensation claim in the future, the tenant must serve on the landlord a notice of his intention to make the improvement, together with a specification and plan showing the proposed improvement and the part of the existing premises to be affected.[32] He must do this even if the lease does not restrict his right to alter or improve the demised premises. There is no prescribed form of notice and no stipulation as to the amount of detail required in the plan and specification, but the notice must be in writing.[33] If the tenant applies for the landlord's consent, under the terms of his lease, his application for that approval can fulfil a dual function, i.e. serving also as notice for the purposes of section 3, even if the tenant gave no thought to the Act and made no reference to it. This point, recently considered by the Court of Appeal[34] but not decided, can be of critical importance. It affects not only the tenant's locus standi to make a claim at the end of the day, but also the landlord's immediate right to respond in particular ways, e.g. by undertaking the work himself.

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[32] s. 3(1).

[33] S. 23(1).

[34] Deerfield Travel Services Ltd. v. Leathersellers of London (1982) 46 P. & C.R. 132, at p. 139.

2.23 The plan and specifications must necessarily be in sufficient detail to allow the landlord to identify and assess what is proposed. Where further details are properly requested, the effective date of a notice is the date when that information is supplied.[35] The landlord's failure to ask for further details may indicate that the given details are sufficient; whether that inference should be drawn is likely to depend on whether the landlord was aware of the purpose of the notice.[36]

2.24 If within three months after service of the notice the landlord does not object, the tenant is entitled to carry out the improvement. He may do so notwithstanding any provision in the lease restricting his rights.[37] A landlord's failure to respond can therefore effectively authorise proposals which, if challenged, would not qualify as proper improvement; e.g. the court might not have been satisfied that the improvement was suitable for the character of the holding.[38] In the absence of objection, the tenant need do no more (beyond actually proceeding with the improvement) to lay the foundations for an eventual compensation claim.

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[35] Ibid., at p. 139.

[36] Ibid., at p.139.

[37] s. 3(4). In Deerfield (above) Templeman L.J. at p. 141 doubted whether it would lie in the mouth of a landlord who had authorised the tenant to start work, to complain that work had begun before the tenant served notice.

[38] See para. 2.25 below.

Application to the court

2.25 If the landlord does object, the tenant can apply to the court[39] for a certificate that the proposed improvement is a proper one. The court's certificate authorises the work and lays the foundation for a compensation claim. The court must be satisfied that the improvement:

(a) is of such a nature as to be calculated to add to the letting value of the holding at the termination of the tenancy;

(b) is reasonable and suitable to the character of the holding (having regard to any evidence of the immediate or the superior landlord, that the improvement is calculated to injure the amenity or convenience of the neighbourhood);

(c) will not diminish the value of any other property belonging to the landlord or to any superior landlord;

(d) is not one which the landlord has offered to execute in consideration of a reasonable increase of rent, or of such increase of rent as the court shall determine.

The court may make such modifications to the plan and specification as it thinks fit and can impose such conditions as it thinks reasonable.[40] The Act clearly anticipates that a time for completing the work may be fixed by the parties or by the court. Failure to meet that time, or to comply with any condition imposed by the court, is fatal to a compensation claim. The court may have a discretion to refuse a certificate even if the proposed improvement satisfies the

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39 S. 3(1).

40 S. 3(5).

listed conditions.[41]

Landlord's undertaking

2.26 The landlord has a right to enter the holding to make any improvement he has undertaken to execute. The Act is silent as to any other resulting rights. The tenant cannot apparently oblige the landlord to perform his undertaking.[42] But if he fails to carry it out, the court can subsequently grant a certificate for the improvement in question. So the landlord cannot avoid the process by volunteering to take over the improvement and then doing nothing. The Act provides no machinery for the tenant to withdraw his proposal if the landlord's undertaking is unwelcome, but maybe he can do so. The landlord has no express right to make the improvement against the tenant's will. It may follow that the tenant can refuse the landlord's offer, and so end the improvement proposal. On the other hand it may be argued that the express statutory power of entry would be otiose if the landlord did not also have some right to insist on carrying out the improvement. The point, now undecided, could be of major

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[41] Cf. English Exporters (London) Ltd. v. Eldonwall Ltd. [1973] Ch. 415 where Megarry J. considered the use of the permissive "may" where used for the court's power to determine an interim rent under s. 24A of the Landlord and Tenant Act 1954.

[42] Unless, of course, he has bound himself contractually. There may be an implied contract, if not an express one, where the tenant accepts the undertaking instead of pursuing his application.

importance.[43]

Certificate of execution

2.27 A tenant who has followed the statutory procedure and has made an authorised improvement can require the landlord to certify that it has been duly executed. If the landlord fails or refuses to comply, the tenant can apply to the court for an equivalent certificate.[44] This certificate serves no immediate purpose, and the tenant is under no obligation to ask for it. But it provides invaluable evidence if a compensation claim eventually follows, perhaps many years later.

The claim

2.28 Compensation is only payable when the tenant quits the holding at the end of his tenancy.[45] So no compensation is

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[43] Effectively reversing the more usual operation of Part I, by allowing the landlord to override the tenant's objections.

[44] S. 3(6).

[45] Smith v. Metropolitan Properties Co. Ltd. [1932] 1 K.B. 314 decided under the former compensation for goodwill provisions.

due while the tenant stays in possession as a trespasser.[46] The amount may however be formally ascertained beforehand.[47]

Formalities

2.29 The tenant's claim must be made in the prescribed manner and within the prescribed time limits. The claim must be in writing signed by the claimant or his solicitor or agent giving (a) the names and addresses of the claimant and his immediate landlord, against whom the claim is made, (b) a description of the holding and the trade or business carried on there, (c) a concise statement of the nature of the claim, (d) particulars of the improvement, including its completion date and cost, and (e) a statement of the amount claimed.

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[46] In many cases the contractual tenancy will be extended under the provisions of the Landlord and Tenant Act 1954. It is arguable that the right to compensation may be lost if the tenancy is not extended but the tenant nevertheless fails to quit on the date of termination, see Cave v. Page [1923] W.N. 178.

[47] Pelosi v. Newcastle Arms Brewery (Nottingham) Ltd. (1981) 43 P. & C.R. 18.

Time for making claim

2.30 If the tenancy expires by effluxion of time, the notice must be served within the period not less than three nor more than six months before the expiry date.[48] The majority[49] of tenancies to which the Act applies are now terminated by notice, either common law notice to quit or notice given under the Landlord and Tenant Act 1954. Then, the claim must be made within the period of three months beginning on the date when the notice was given.[50] As a result of the statutory security of tenure enjoyed by most business tenants, the notice will in many cases not cause the tenant to quit the holding, either at all, or until much later than the date specified in the notice. Nevertheless, the claim must have been lodged within three months after the notice, and there is no power in the court to extend that time.[51] If the tenancy is determined by forfeiture or re-entry, the tenant must serve his claim on the landlord within the three months beginning on the date of re-entry if there is no order for possession, otherwise beginning on the effective

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48 Landlord and Tenant Act 1954, s. 47(2).

49 Most of them will qualify as business tenancies under the 1954 Act, which can only be terminated by surrender, forfeiture or by notice under the statute, see s. 24(2).

50 Landlord and Tenant Act 1954, s. 47(1).

51 Donegal Tweed Co. v. Stephenson (1929) 98 L.J.K.B. 657. It has not been decided whether, on an application made out of time, a landlord could be taken to have waived his right to object, cf. Kammins Ballroom Co. Ltd. v. Zenith Investments (Torquay) Ltd. [1971] A.C. 850, where it was held under the 1954 Act that the court could entertain an out of time application if the landlord waived his right to object.

date of the possession order.[52]

Amount of compensation

2.31 The compensation payable cannot exceed

(a) the net addition to the value of the holding as a whole which may be determined to be the direct result of the improvement, or

(b) the reasonable cost of carrying out the same improvement at the termination of the tenancy.[53]

The formula is designed to ensure that the compensation payable reflects the actual value of the improvement to the landlord.

2.32 The amount by which the landlord benefits from the improvement can be reduced or eliminated if the premises are demolished or altered after the end of the tenancy, or they are used for a different purpose. These matters must be taken into account when deciding the amount of the net addition to value in fixing the compensation. The tenant is safeguarded against a landlord who fails to carry out a stated intention. If the compensation is reduced or refused because of proposed

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[52] Landlord and Tenant Act 1954 s. 47(3).
[53] S. 1.

changes, and the changes are not made within a time fixed by the court,[54] a further application may be authorised. Other considerations may also reduce the net addition to value made by an improvement; the Act appears to contemplate that the works "might in some respects be detrimental and in other respects beneficial to the holding".[55] The reasonable current cost is subject to deduction of an amount equal to the cost (if any) of putting the improvement into a reasonable state of repair, unless the tenant is under an obligation to meet that cost. Thus, subject to the effect of repairing covenants, the compensation will not be assessed on the basis of the improvement being in a better state of repair than it really is.

2.33 The claim is also reduced where the tenant or his predecessors have received, from the landlord or his predecessors, any benefit in consideration expressly or impliedly of the improvement.[56] This seems appropriate to cover cases where the landlord contributes to the tenant's expenditure without being contractually liable to do so,[57] and possibly where he reduces the rent or forgoes an increase.

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[54] S. 1(3).

[55] Per Morton J. in National Electric Theatres Ltd. v. Hudgell [1939] Ch. 553 at p. 561.

[56] S. 2(3).

[57] I.e. not contractually liable to do so under an agreement which obliged the tenant to make the improvement; cf. Landlord and Tenant Act 1927, s. 2(1)(b).

The proviso does not appear to have been tested.[58]

Contracting out

2.34 Part I of Act applies notwithstanding any contract to the contrary.[59] Originally there was a proviso which required the court to give effect to any such contract made for adequate consideration. Although that no longer applies, such consideration could go to reduce the claim under section 2(3) if it is a benefit passing from landlord to tenant in consideration of the improvement, e.g. if the tenant accepts compensation offered before the end of the tenancy in final

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[58] The editors of Woodfall's Law of Landlord and Tenant 28th ed., at para. 2-0768, make the point that the operation of s. 2(3) appears to be very uncertain, because improvements made in pursuance of a contract for valuable consideration are excluded by s. 2(1)(b), making it difficult to see what is intended to be covered by s. 2(3). It may be that the term "consideration" is not used here in its technical sense meaning one of the essential elements of a valid contract (so that so-called "past consideration" does not count) but is used loosely to indicate some express or implied connection between the improvement and the benefit received.

[59] S. 9.

settlement.[60]

Summary of procedure

2.35 In summary, the procedural steps which tenants must take to claim compensation are:

(1) notice of intention must be served (paragraph 2.22);

(2) the tenant must then wait for three months before starting work in case there is an objection (paragraph 2.24);

(3) if the landlord objects, the tenant must apply to the court for a certificate under section 3,(paragraph 2.25);

(4) if a certificate has been refused on the ground of the landlord's offer to execute the improvement and he has failed to do so, the tenant must apply again (paragraph 2.26);

(5) after completing the improvement, the tenant may apply to the landlord for a certificate of due execution (paragraph 2.27);

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[60] But see above, especially n. 57.

(6) if no certificate is given within one month, the tenant may apply to the court for a certificate (paragraph 2.27);

(7) within the time specified before or after the end of the tenancy (depending on the manner of termination) the tenant must lodge his application for compensation with the landlord (paragraph 2.30);

(8) unless the claim is met by agreement, the tenant must apply to the court within three months (paragraph 2.30).

B OTHER PROVISIONS AFFECTING TENANTS' IMPROVEMENTS

The effect of business tenants' improvements on rent

2.36 In assessing the rent to be paid under a new tenancy of business premises granted under Part II of the Landlord and Tenant Act 1954, the court is directed to disregard any effect on rent of certain improvements. Those are improvements carried out by a person who was then the tenant,[61] otherwise than in pursuance of an obligation to his immediate landlord. The effect of an improvement is to be disregarded if:

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[61] Thus, an improvement carried out by a licensee to whom a lease is subsequently granted is not disregarded, see Euston Centre Properties v. H. & J. Wilson (1982) 262 E.G. 1079.

(a) it was carried out during the current tenancy (which means the tenancy which entitles the tenant to apply for a new lease); or

(b) it was completed within twenty-one years before the application, and after completion the holding has been continuously subject to business tenancies governed by Part II of the Act without any tenant quitting the premises on the termination of any such tenancy.

2.37 The business tenancies covered by Part II of the Landlord and Tenant Act 1954 are not co-extensive with those covered by the improvement provisions of the 1927 Act,[62] but in practice relatively few tenancies will fall within one, but not the other set of provisions. Also, both Acts seem to be concerned with the same kind of "improvements", i.e. works which affect the letting value of the holding at a particular stage, whether during or after the tenancy. There are some differences. One is that the 1927 Act envisages only improvements which will enhance the letting value, while the 1954 provisions are also appropriate to deal with "improvements" whose effect is detrimental to the letting value. Another is that tenants' improvements carried out before the current tenancy may have to be considered when fixing a new rent, but are probably not eligible for compensation when the tenant ultimately quits the premises.[63] Similarly, tenants' fixtures are excluded from the compensation provisions but can qualify as improvements to be disregarded in fixing rent under a new tenancy.

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[62] See para. 2.6 above.
[63] See para. 2.18 above.

Unreasonable withholding of consent to improvements

2.38 Section 19(2) of the 1927 Act, which is not restricted to business tenancies, implies a proviso to any covenant which prohibits improvements being undertaken without the landlord's consent. The proviso is that the consent shall not be unreasonably withheld. The tenant can therefore do the work[64] if the consent has been withheld unreasonably. The onus is on the tenant to show that the withholding was unreasonable. The proviso does not apply to mining leases, to tenancies of agricultural holdings or to tenancies subject either to section 81 of the Housing Act 1980 or section 97 of the Housing Act 1985 (to which special provisions apply, see below, paragaraph 2.40).

2.39 Works which qualify as improvements for this purpose do not necessarily fall within the compensation provisions. The vital distinction is that under section 19(2), the landlord may have to approve work which does not enhance the letting value of the holding.[65] Indeed, there are special safeguards for the landlord in such a case. The proviso allows him to make his consent conditional on the tenant's payment of a reasonable sum in respect of any damage to or diminution in the value of the demised premises or any neighbouring premises belonging to him. It also allows him to require an undertaking for reinstatement where reasonable. But the mere fact that it would have been reasonable to impose

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[64] Landlord and Tenant Act 1927, s. 1.

[65] E.g. Lambert v. F.W. Woolworth & Co. Ltd. (No. 2) [1938] Ch. 883 where the Court of Appeal held by a majority that work facilitating better use of the demised unit as part of larger, composite premises was capable of amounting to an improvement.

conditions does not justify an unconditional refusal of consent.[66]

Tenancies of dwelling houses

2.40 It is now an implied term of most secure, protected and statutory tenancies[67] that the tenant shall not make any improvement to the demised premises without the written consent of the landlord, such consent not to be unreasonably withheld.[68] Section 19(2) of the 1927 Act no longer applies to those tenancies. In this context improvements are widely defined to mean "any alteration in, or addition to" a dwelling-house, and specifically to include:

> "(a) any addition to or alteration in landlord's fixtures and fittings,

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[66] Lambert v. F.W. Woolworth & Co. Ltd. (above).

[67] Secure tenancies are the public sector residential tenancies to which Part IV of the Housing Act 1985 applies. Protected and statutory tenancies are the residential lettings by private landlords to which the main provisions of the Rent Act 1977 apply.

[68] The provisions were introduced by the Housing Act 1980, ss. 81 - 83, which still apply to protected and statutory tenancies. Secure tenancies are now subject to the parallel provisions of ss. 97 - 99 of the Housing Act 1985, and the additional provisions of ss. 100 and 101.

(b) any addition or alteration connected with the provision of services to the dwelling house,

(c) the erection of a wireless or television aerial, and

(d) the carrying out of external decoration."[69]

The onus is on the landlord to prove that his refusal was not unreasonable,[70] and where consent has been unreasonably withheld it is treated as having been given.[71] The court is directed, in considering reasonableness, to have regard to the extent to which the improvement would be likely to make the dwelling house less safe for occupiers, to cause extra expenditure by the landlord, or to reduce the open market selling or rental value.[72]

2.41 Local authorities and other landlords[73] of secure tenants are empowered but not obliged to reimburse monies to tenants who have made improvements for which consent was, or

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[69] Housing Act 1980, s. 81, Housing Act 1985, s. 97.

[70] Housing Act 1980, s. 82(1), Housing Act 1985, s. 98(1).

[71] Housing Act 1980, s. 81(3), Housing Act 1985, s. 97(3).

[72] Housing Act 1980, s. 82(1), Housing Act 1985, s. 98(2).

[73] See "the landlord condition" in the Housing Act 1985, s. 80.

was deemed to be given.[74] Payments can only be made at the termination of a tenancy. The amount must not exceed the cost or likely cost of the improvement, less the amount of improvement and other grants "in respect of the improvement."[75] Rent increases are restricted so that the improving tenant and his statutory successors will not pay the increased rent attributable to an improvement (or part of an improvement) financed by the tenant.[76]

Recommendations already made by the Law Commission

2.42 In our Report on Covenants Restricting Dispositions, Alterations and Change of User[77] we considered whether, in the light of the new provisions of the Housing Act 1980, there was still any place, in any kind of tenancy, for covenants which amounted to absolute prohibitions of works of improvement. We concluded[78] that absolute covenants by tenants against making

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[74] Ibid., s. 100.

[75] This provision is capable of an interpretation requiring deduction of a sum available as a grant but not actually paid.

[76] Housing Act 1985, s. 101. The tenant is here treated as bearing any cost which he would have borne but for an improvement, intermediate, special or repairs grant. S. 101 does not apply when the interest of the landlord belongs to a co-operative housing association.

[77] (1985) Law Com. No. 141, published in March 1985.

[78] Ibid., para. 4.64.

alterations[79] should continue to be permitted in all cases which were not already covered by the special Housing Act provisions.[80]

2.43 One of our principal recommendations was that any qualified[81] alteration covenant contained in a future tenancy should take effect as a fully qualified[82] covenant. We suggested that the proviso implied by section 19(2) of the Landlord and Tenant Act 1927 should have an extended application, i.e. to apply to mining and agricultural tenancies, because there was no case for special exclusion.[83] We further recommended that if a tenant's power to make alterations was the subject of a qualified covenant, that covenant should become qualified as a whole and not merely

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79 Ibid., para. 2.4. An absolute covenant is one by which the tenant simply undertakes that he will not do the thing in question at all.

80 Then ss. 81-3 of the Housing Act 1980. The cases not so covered would be mostly business tenancies, and long-term residential tenancies.

81 (1985) Law Com. No. 141, para. 4.74. A qualified covenant is one by which the tenant undertakes not to do the thing in question unless the landlord consents to it, ibid., para. 2.4.

82 Ibid., para. 6.2 A fully qualified covenant is one which takes the form of an undertaking by the tenant not to do the thing in question unless the landlord consents to it, but which contains an additional stipulation that the landlord may not withhold his consent unreasonably, ibid., para. 2.4. None of the recommendations has yet been implemented.

83 Ibid., para. 6.13.

insofar as it dealt with improvements.[84]

2.44 Other recommendations which could be directly relevant to tenants' improvements are our recommendations that:

(1) damages should be payable when consent has been unreasonably withheld or not given within a reasonable time;[85]

(2) the onus should be on the landlord withholding consent to show that he has acted reasonably;[86]

(3) the landlord should be entitled to compensation for loss or damage of any kind which the proposed alteration would cause, or an indemnity where that would be more appropriate, e.g. where the result would be an increase in the landlord's outgoings;[87] and

(4) where there is a (reasonable) condition of reinstatement there may also in appropriate cases be a requirement that the tenant provide security for

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[84] Ibid., para. 6.12.
[85] Ibid., para. 8.65.
[86] Ibid., para. 8.11.
[87] Ibid., para. 8.29.

his performance of that obligation.[88]

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[88] Ibid., para. 8.49.

PART III

THE NEED FOR COMPENSATION

Residential property

3.1 We have identified two principal justifications for statutory schemes which allow tenants to claim compensation from their landlords for improvements they make to the demised premises. They are: first, the improvement made and financed by the tenant can bring the landlord an unexpected, and perhaps unjustified, benefit; secondly, there is a public interest in the improvement of property. Both these reasons apply not only to tenants of business property, who now benefit from a compensation scheme, but also to residential tenants, who do not.

3.2 The suggestion that residential tenants should be compensated is not new. This was recommended by the Jenkins Committee in 1950.[1] The possibility was again considered, in 1970, by our Working Party on landlord and tenant.[2] They thought that a right to compensation for improvements approved by the court might prolong the life of some privately rented accommodation which would otherwise deteriorate, by encouraging tenants to do work on them. The working paper incorporated this suggestion and responses to it were evenly divided on the desirability of compensation for residential

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[1] The Final Report of the Leasehold Committee (1950), Cmd. 7982.

[2] (1970) Working Paper No. 25.

tenants. As we have already mentioned,[3] landlords of secure tenants now have the power to pay compensation, but the tenants have no right to insist on payment.

3.3 Residential tenants contemplating improvement cannot make such precise calculations of the financial consequences as are usually possible for a business tenant. In the first place, the tenant of commercial premises will often be looking to a positive financial return, in the form of increased production or reduced overheads, on his investment in the improvement. For the residential tenant, the improvement may offer greater comfort or greater convenience, but the benefit to him may be something which cannot be measured in terms of money. In the second place, we believe that most tenancies of business premises are leases for a fixed term of years. On the other hand, residential tenancies - disregarding long leases where the problem is unlikely to arise - are often periodic tenancies. Although statutory protection ensures that the tenant has security of tenure, the period for which the tenancy will last may depend on how long he lives or other family circumstances. Again, therefore, a precise financial calculation, spreading the cost of the improvement over the remaining period of the tenancy to decide whether it is worthwhile, is not possible. This increased degree of unpredictability suggests that there is a greater justification for compensation for residential tenants than in the case of business tenants, because the likelihood of unexpected benefit to the landlord is greater.

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[3] See para. 2.41 above.

3.4 There are, however, a number of arguments against extending compensation for improvements to residential tenants arising from the particular circumstances in which it might apply:

(a) The most important group of short-term residential tenancies is probably now those granted by public sector landlords. All the costs which those landlords incur in connection with the tenancies come out of the total amount of money allocated for public sector housing. It is therefore probable that to allocate money to compensation for improvements would divert resources from other housing projects. To give tenants a right to insist on compensation would be tantamount to giving them the chance to dictate the allocation of public housing funds, and this does not seem to be appropriate. Further, it is possible that public sector housing would be improved by tenants to unreasonably high standards for housing stock which is intended to provide satisfactory accommodation at relatively low rents. The fact that the landlord was able to obtain payment of a higher rent as a result of the improvement would not help it to fulfil its role in providing housing for those with modest means. The end result might simply be the need to increase financial assistance towards the payment of rent. We think that these consequences make the introduction of a compensation scheme for the public sector undesirable.

(b) The amount of accommodation available for renting in the private sector has, over the years, fallen dramatically, and is probably still falling. Since 1965, various amendments to the Rent Act have encouraged the temporary letting of accommodation in certain classes, e.g. houses and flats in which the landlord previously lived as owner-occupier,[4] properties purchased for retirement[5] and accommodation owned by servicemen.[6] In many of these cases, the expectation is that the landlord will later resume occupation. We do not think that to give tenants rights to insist on improving such property, and then to make the landlords pay compensation before resuming possession, accords with the intention of the legislation seeking to make these properties available to rent.

(c) Some other properties can be rented in the private sector on a short-term basis, e.g. lettings to students while at college.[7] Again, it seems inappropriate to authorise the improvements for which, if the tenancy comes to an end not long after the work is completed, the landlord would effectively be obliged to pay.

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[4] Rent Act 1977, Sched., 15 case 11.

[5] Ibid., case 12.

[6] Ibid., case 20.

[7] Rent Act 1977, s. 8.

3.5 For these reasons, we have reached the provisional conclusion that there should be no general statutory right for residential tenants to claim compensation for improvements from their landlords. However, we recognise that the arguments are finely balanced, and we should be interested to learn whether or not others agree with our conclusion.

Business property

3.6 Merely because there has for over sixty years been a statutory scheme for landlords to compensate tenants in respect of improvements to business property does not mean that it is necessarily appropriate that the scheme should continue. In examining Part I of the Landlord and Tenant Act 1927, therefore, the first question to ask is whether there is still a need for a statutory right to compensation. Certainly, our preliminary investigations and our general experience indicate that the procedure is not often used.

3.7 A major argument in favour of discontinuing the scheme is founded in the change of circumstances since 1927. The introduction of the statutory right to renew tenancies of business premises, by Part II of the Landlord and Tenant Act 1954, materially changed the balance between landlords and tenants of these premises. For most business properties it is now true that a tenant who wishes to remain in possession after his lease has expired will be able to obtain a new tenancy. There are of course exceptional cases in which the

landlord can resist a tenant's application to renew. Probably the most common is where the landlord intends, when the current tenancy ends, "to demolish or reconstruct the premises comprised in the holding or a substantial part of those premises".[8] In such a case it is unlikely that there will be any payment of compensation for an improvement even if a claim has been established.

3.8 This later statutory intervention does nothing to adjust the balance of fairness between landlord and tenant, and nothing to compensate a tenant where the landlord unexpectedly obtains a benefit from an improvement effected by the tenant. What it does do, however, is substantially to remove any deterrent which a tenant might feel from improving the premises which he occupies based on a fear that he might not be able to enjoy the full benefit of the improvement. Any public interest in encouraging the improvement of business property, or at least removing factors discouraging it, is probably therefore satisfied.

3.9 The present compensation scheme can also be criticised for awarding compensation of an amount which ignores relevant financial factors to such an extent that it could be said to be capricious. On the face of it, calculation of compensation accurately ensures that the landlord pays the tenant the value of the improvement which he inherits on the lease coming to an end. That is effectively the same as the amount of the tenant's expenditure which, because the lease ended, he has

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[8] Landlord and Tenant Act 1954, s. 30(1)(f).

not been able to enjoy. However, because of modern fiscal interventions, the calculation may not be nearly so simple. The improvement may have been work for which the tenant was able to claim a substantial contribution from public funds or which enabled him to reduce his liability to tax. This could arise because the expenditure reduces his taxable profit, because it attracts specific allowances which he is entitled to set off against tax liability, because he enjoys concessions from rating liability, and probably from other causes. Further, differing tax treatment of the payment of the compensation by the landlord and the receipt of it by the tenant can also reduce the degree of realism in the calculation.

3.10 The fact, if it is one, that the present compensation provisions are little used is one from which it is difficult to draw a definite conclusion. It is certainly not possible automatically to say that comparative neglect means that the compensation scheme is not wanted and can therefore safely be dispensed with. The reason for lack of use may be that certain details are unsatisfactory, and therefore deter some potential users, or even allow them to lose compensation rights unintentionally. If this were to prove to be the case, it is an argument for reforming the system rather than abolishing it.

3.11 In the past, it has been urged upon us[9] that a major advantage of the scheme is that it offers a standard against which landlords and tenants can negotiate for compensation, on

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[9] In the course of an earlier consultation.

the basis that it is only in rare cases that they will need to fall back on the statutory rights. Looked at in this way, rather than saying that the scheme is only rarely used, one should perhaps rather say that the figures show that it is still necessary for tenants regularly, although not in large numbers, to resort to their statutory rights.

3.12 If the abolition of the compensation scheme is suggested, the transitional position should be considered. There will be some tenants who have a potential claim for compensation, although until their leases come to an end it is not possible to say whether that claim will result in any payment. They may have taken the decision to spend money on the improvement in reliance upon the existence of the compensation scheme, and in those circumstances we cannot see any justification for depriving them of their potential benefit, merely because it is judged that the scheme no longer has any general utility. As compensation claims can arise under long leases for such substantial improvements as new buildings, which can retain a residual value for many years, the transitional period could be lengthy, and it would not be possible to place a limit on it. An alternative approach would be to insist that tenants claiming a right to compensation should, if they wished to retain it, establish and perhaps register it during a relatively short transitional period. That would be likely to cause a substantial amount of unnecessary work for both landlords and tenants in those cases in which although a claim can be established, there is in the end no payment of compensation, either because when the lease

eventually ends there is no residual value in the improvement, or because at that time the landlord proposes to demolish the building which contains or comprises the improvement.

3.13 It seems to us that the argument for the compensation scheme for business tenants is much less strong now than it was when first introduced. Indeed, if there were none now, and it were suggested that one be introduced, we think it unlikely that we would support the suggestion. However, we are influenced by the fact that we already have an established scheme familiar to those negotiating about business property, and under which many people must have established rights. Accordingly, we provisionally recommend that the scheme established by Part I of the Landlord and Tenant Act 1927 should continue, subject to the reconsideration of its details. The appropriateness and utility of the scheme are primarily matters for the judgment of those who let and take tenancies of business property, and before reaching a final conclusion we should particularly welcome their comments on the need and utility of retaining the system.

3.14 The present compensation scheme has been subject to a number of detailed criticisms. If it is to be kept, it should be on the basis of meeting as many of those as possible. In the next three Parts of this working paper we therefore examine those criticisms and make some suggestions for reform.

PART IV

CASE FOR REFORM

An outline of criticisms

4.1 The most striking defect in the existing compensation provisions is the inherently wasteful and cumbersome nature of the machinery, but there are other aspects which have been subject to criticism, or may require review. These concern the categories of tenant eligible to apply, the improvements which qualify for compensation, the measure of compensation payable and the apparent ease with which landlords can contract out of liability to pay compensation.

4.2 It seems unsatisfactory that the definition of tenancies which are eligible should not be in line with other legislation affecting business tenancies. At least the inessential differences between the definitions of business premises which can qualify tenants for security of tenure, and business premises where improvements can attract compensation, should be removed.

4.3 Other criticisms relate to the tests, as opposed to the formalities, which must be satisfied if an improvement is to qualify for compensation. There is no explicit definition of improvement. Also, the fact that a business tenant could secure a new lease, by statute or otherwise, after improving the demised premises may not be a good reason to deprive him of any right to compensation. The result may be unnecessarily to discourage longer term improvements.

4.4 The measure of compensation payable on a successful claim may also be criticised because it bears no relation either to the tenant's expenditure or to the loss he suffers. The present measure of compensation is designed only to prevent the landlord from benefiting at the tenant's expense. The right to compensation may be reduced or even obliterated by the landlord's intentions for the future use or redevelopment of the property.

4.5 The apparent paucity of compensation claims may be attributable in no small measure to the cumbersome preliminary formalities, neglect of which prevents many tenants even contemplating a claim, let alone succeeding in one. Those preliminary formalities may be unnecessary at least in their present form.

4.6 There is another complication in the rules which face a tenant who wishes to improve business property, and this is also a source of criticism. The Landlord and Tenant Act 1927 deals not only with compensation for improvements, but also with obtaining the landlord's authority to do the work. At present it is not possible to ensure that a person who has the right to do the work necessarily qualifies for compensation. A greater integration between the two provisions should also eliminate duplication of preliminary formalities.

Aims of reform

4.7 Assuming, as we are, that the statutory compensation scheme should be retained, the aim of any reform should be to make it as effective as possible. This means that unnecessary preliminary formalities should be cut out; the details of the scheme should be clarified; it should as far as possible be integrated with other and more familiar legislation relating to business tenancies; and it should be related to perceived current needs.

4.8 In the next Part of this working paper, we consider how the scheme can be simplified. In the following Part we examine in detail, and make reform suggestions in answering the following questions:

(a) Which tenants should qualify for compensation?

(b) For what improvements should compensation be paid?

(c) How much compensation should be paid?

(d) How far, if at all should parties be allowed to contract out of the compensation provisions?

(e) How should compensation be claimed?

PART V

SIMPLIFICATION OF SCHEME:

REFORM PROPOSALS

5.1 A tenant who wishes to claim compensation for his improvements must follow the prescribed procedures both at the preliminary stage before he starts work on the improvement, and at the end of the tenancy when his right to compensation crystallises. He may be involved in a contested application to the court at either or both of those stages.

5.2 The present system aims to ensure that the evidence identifying, and proving the eligibility of an improvement for compensation, will be available from the time the work was done. When the claim is finally made, the tenant (or the landlord) can produce plans and specifications, documents or a court order to show whether the improvement qualifies for consideration, and (if it was requested) a certificate that the improvement was duly executed by the tenant.

Preliminary procedure to stake compensation claims

5.3 The severe criticism of the preliminary requirements is that they are not really necessary and can involve considerable expense, which may be totally wasted. It is unnecessary, because there is generally sufficient evidence to identify the improvement, and its eligibility for compensation

can perfectly well be tested when the claim is made.[1] The absence of any equivalent formalities causes no problems when tenants claim to have the effect of improvements disregarded in fixing the rent on a tenancy renewal.[2] Moreover, the cost and effort of the procedure before making the improvement may very easily be rendered abortive, but the tenant cannot then know whether they will. They can be wasted as the result of matters beyond the control of the parties as well as the parties' own acts. The claim may ultimately fail because the landlord decides to demolish the improved property, because the improvement deteriorates quickly, or because of a drop in demand for that kind of improved property. The right to compensation may simply lapse, when the tenant substitutes new improvements which supersede the old ones.

Preliminary procedure to authorise improvements

5.4 The preliminary procedure which seems unnecessary for claiming compensation[3] is nevertheless useful to a tenant otherwise lacking the power to carry out a proposed improvement. The court's certificate that the proposed improvement is a proper one makes it lawful for him to

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[1] The fact that a proposed improvement passes the preliminary tests does not mean that it will be eligible for compensation when the claim is made.

[2] See e.g. New Zealand Government Property Corporation v. H.M.& S. Ltd. [1982] Q.B. 1145.

[3] See para. 5.3 above.

proceed, notwithstanding any prohibition contained in the lease.[4] If there is an absolute prohibition in the lease, use of the Part I procedure is the only method available to the tenant of getting authority, in the absence of actual consent from the landlord.

5.5 Business leases very commonly contain tenants' covenants not to make any alterations without the landlord's consent. That consent may not be unreasonably refused either because the covenant says so, or (if the alteration would be an improvement) because of the proviso implied by section 19(2) of the 1927 Act. The reasonableness of a refusal can be tested in the courts. The tenant will be in breach of covenant if he fails to ask for consent, or ignores a reasonable refusal.

5.6 These procedures overlap, but at least they do serve different functions. What seems unsatisfactory is that they are not integrated as fully as they should be. Obviously, full integration cannot be achieved so long as the certification process applies to a narrower category of tenancies and does not use the same criteria to decide what is an improvement as section 19(2). However, where there is an improvement where either could apply, the provisions should be integrated, so that there cannot be two different results according to which procedure the tenant selects. As the law now stands, the tenant can proceed with an improvement without even asking for consent as required by the terms of his lease;

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[4] See para. 2.25 above.

but the landlord will have had notice, and an opportunity to have his objections heard. A more serious criticism is that his reasonable grounds for refusing consent will not necessarily prevent the court from granting a certificate, although it may be a factor to take into account when considering the grant of a certificate. Nevertheless it seems to us unsatisfactory that a landlord's refusal which would be upheld as reasonable should be capable of being overridden by a certificate.

The effects of the present requirements

5.7 Eliminating the present preliminary requirements, to simplify the procedure might prejudice landlords. This can best be considered by noting the effects the preliminary requirements have, judging whether they are really valuable or useful to landlords, and if so, how far they can be achieved in some other way. This is a summary of the present position:

(A) In all cases

(1) A landlord faced with a compensation claim has always had advance warning that a claim might be made.

(2) He has also had an opportunity to offer to do the work himself, which could have eliminated any question of compensation.

(B) In cases where the terms of the tenancy do not prohibit the proposed work

(3) The landlord cannot prevent the proposed improvement.

(4) He can ensure that the improvement is never eligible for compensation unless the court is satisfied that it:

(a) is calculated to add to the holding's letting value at the end of the tenancy;

(b) is reasonable and suitable to the character of the holding;

(c) will not diminish the value of other property belonging to the landlord or a superior landlord; and

(d) is a proper one.

(C) In cases where the terms of the tenancy prohibit the proposed work

(5) The landlord can prevent the tenant from carrying out the proposed improvement if the court is not satisfied on the four conditions referred to above.

5.8 We now consider whether these effects of this preliminary procedure serve a useful purpose which ought to and could be preserved. We take each in turn.

A In all cases

(1) Notice

5.9 A landlord can reasonably wish to know in advance about his tenant's intention to make an improvement even apart from any liability to pay compensation. Improvements can affect a property's value for insurance, rating and other purposes. The landlord's own financial plans may be significantly affected by that knowledge or lack of it. For all these reasons we accept that tenants should give notice of their intention to improve. We accept that landlords can ensure that they are notified by taking a covenant against such works being done without their consent. However, the sanctions for breach of covenant seem inappropriate. Forfeiture is a disproportionately harsh remedy, while damage would be hard to establish.

(2) Offer to undertake work

5.10 We incline to the view that landlords should continue to have the option to offer to do the work, and by that means escape all liability for compensation. This allows them to choose to invest ascertainable amounts immediately, rather than face contingent claims whose amount and timing must be uncertain. It means that the improvement the tenant wants can be made, although the financial consequences will be different from those he expected. We also wish to consider whether a landlord who has signified his willingness to undertake the

proposed work should acquire a positive right to do so, not merely a veto on the tenant's right to proceed. If the tenant cannot withdraw his improvement proposal he is in no worse position than a landlord, who may not have favoured a tenant's improvement, but may nevertheless have to pay for it later. Tenants may also object to losing control over their own proposals: the landlord's workmanship may prove inferior to what the tenant envisaged, or his expenditure may be higher. One possible solution is to place the landlord under a positive obligation to carry out the work in accordance with that tenant's specifications. We invite views on two points: first, should a landlord be entitled to insist on doing the improvements proposed by his tenant? and secondly, if that rule is adopted, what safeguard does the tenant need?

B Where the terms of the tenancy do not prohibit the proposed improvement

(3) No prevention of the improvement

5.11 When the landlord is not in a position to prevent the tenant from improving the property - either because the tenancy imposes no restriction, or because the tenant has satisfied the conditions, e.g. by obtaining all necessary consents - the tenant's use of the statutory compensation procedure does not give the landlord any extra power of prevention or control. In these circumstances, a change cannot deprive the landlord of any rights he currently enjoys.

(4) Barring the compensation claim

5.12 The landlord can block any later compensation claim by objecting, when the improvement is proposed, that it does not satisfy the four statutory tests. We consider each of the tests.

(i) Calculated to increase letting value

5.13 It is inherently improbable that an improvement which does not even initially seem likely to enhance letting value will in fact do so. Withdrawing this ground of objection is therefore rarely likely to prejudice a landlord.

(ii) Reasonable and suitable to the character of the holding

5.14 Planning controls which have been introduced since 1927 will sometimes put unsuitable proposals beyond the power of the tenant. Again, many "improvements" which would fail this test may also fail the test of adding to the value of the holding. Landlords can generally contract for the benefit of this test, because the unsuitability or unreasonableness would almost certainly be a reasonable ground for refusing consent. A landlord who does not take a covenant against improvements being made without his consent, may be seen as prepared to sacrifice this degree of control.

(iii) Diminution in value of other property

5.15 It is readily understandable that the fact that an improvement would have a detrimental effect on the landlord's other property should be a ground for blocking any future claim to compensation. A detrimental effect on the demised property itself is taken into account in computing the net addition to value at the time of the award. The detrimental effect on other property cannot always be taken into account at that stage. Actual loss is likely to have been suffered continuously since the improvement was made, and the actual loss may well have been suffered by a person who is not the landlord when the claim is made. The landlord may, e.g. sell his other, affected property at a loss, without enjoying a corresponding increase in the value of the demised premises.

(iv) A proper improvement

5.16 We have already explained[5] our conclusion that the court probably has a discretion to refuse a certificate even where the three specific tests are met, if not otherwise satisfied that the improvement is a proper one. Even if there is such a discretion it is difficult to see that it could be exercised in favour of a landlord who merely objects to paying compensation.

5.17 In summary, therefore, the material potential prejudice to landlords from the abolition of the present preliminary procedure before compensation claims for improvements which they could not have prevented, is limited

[5] See para. 2.25 above.

to cases which would detrimentally affect other property they own.

C Where the terms of the tenancy prohibit the proposed work

(5) Prevention of the improvement

5.18 The total abolition of the section 3 procedure would restore the landlord's absolute right to prevent improvements, which would be a complete reversal of policy. Using the procedure for authorising otherwise unlawful improvements rather than for staking a compensation claim does not attract the criticism of wastefulness because the procedure is complete in itself, and no second stage is needed. Unless there is to be a major change in policy - for which we see no justification - a preliminary procedure in some form will be needed for authorisation purposes.

Ban on absolute covenants

5.19 An alternative to retaining a special preliminary procedure would be the statutory conversion of all absolute covenants into fully qualified covenants. We have recently considered that possibility in a wider context and decided to make no recommendation designed to ban absolute covenants in business tenancies.[6] We have not changed our view. There may be little difference on paper between banning absolute covenants and giving the court power to undermine their

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[6] See (1985) Law Com. No. 141, para. 4.62.

effect, but we think that there may be a significant practical difference. The presence of an absolute covenant in a business lease (albeit capable of being overridden on a special application) does indicate that the landlord probably has particular reasons for resisting alteration.

A revised authorisation procedure

5.20 As explained above, we are anxious to avoid the need for a preliminary procedure to establish a claim to compensation. No formalities should be required before the tenancy comes to an end, other than a bare notification, which it is fair for the landlord to have for a number of reasons. On the other hand, the authority which section 3 of the 1927 Act gives to tenants to make improvements is valuable, and not wholly duplicated at the moment. We are therefore seeking an authorisation procedure which will fulfil the functions we have identified as valuable, without going further to impose unnecessary burdens on the parties.

5.21 The functions which any new authorisation procedure should fulfil are:

(a) The tenant gives the landlord prior notice, before the work is done (paragraph 5.9).

(b) The landlord should be able to opt to do the work, and possibly to insist upon doing it (paragraph 5.10).

(c) The landlord should be able to resist any compensation claim based on an improvement which depreciates the value of other property of his (paragraph 5.15).

5.22 The first of these functions, notification to the landlord, can be achieved simply by requiring the tenant to give notice to the landlord before carrying out improvement work if he wishes later to make a compensation claim. Certainly, this perpetuates the two-stage procedure, but it is a major simplification compared with the present law. The requirement would be satisfied by an application to the landlord for consent under the terms of the lease, but would still be needed in cases where the lease imposed no restrictions. We do not propose an implied covenant by tenants who notify the landlord, as the sanction of forfeiture for failure to give notice seems unduly severe. To deprive the tenant of the chance of compensation seems a sufficient sanction.

5.23 We believe that the second function - allowing the landlord to do the work - can be achieved by amending section 19(2) of the 1927 Act. At present, this implies a proviso into any qualified tenant's covenant against making improvements without consent, to the effect that the consent shall not unreasonably be withheld. It expressly permits the landlord to impose a condition requiring a payment to cover damage to or diminution in the value of neighbouring premises of the landlord, and for legal and other expenses incurred in

connection with the consent. It also allows the landlord to impose a reinstatement obligation where the improvement does not add to the letting value of the property, and it would be reasonable to do so.

5.24 We propose that the statutory implied proviso should be further qualified, by treating any refusal to consent by the landlord as reasonable if he undertakes an obligation to the tenant to carry out the improvement, albeit in return for an appropriate rent increase. If the amount of the increase is not agreed, it can be determined by the court.

5.25 The third function, to prevent the landlord having to pay compensation for work which depreciates the value of other property he owns, is already adequately covered by section 19(2). Certainly, the compensation claim is not barred, but financial terms can be imposed on the consent, which in an appropriate case can be made to amount to the same thing.

Transitional provisions

5.26 If the preliminary procedure for compensation claims is dropped, it is necessary to consider whether landlords should have to pay for work already done but for which a tenant did not operate that procedure. We consider that it would be unfair to relax those rules retrospectively. It would be unfair to landlords who believed that no claim could be made. It could also be seen as unfair to conscientious tenants who had meticulously followed the prescribed

procedure, perhaps at considerable expense, in order to be qualified to make a claim which in future would be open to all tenants.

5.27 Future improvements by tenants with existing leases pose other problems. Much of the point of the reform exercise would be lost if the preliminary procedure were retained as a condition precedent for some compensation claims, but not all. We do not consider that landlords of premises already let will be prejudiced by the abolition of the statutory procedure, provided that compensation for future improvements is limited to those made with the landlord's consent.

PART VI

COMPENSATION: DETAILED REFORM PROPOSALS

A TENANCIES UNDER WHICH COMPENSATION IS PAYABLE

Business tenancies

6.1 It is easy to assume, incorrectly, that the compensation provisions of the 1927 Act and the security of tenure provisions of the 1954 Act apply to the same business tenancies. If they did, this area of the law would be simpler to understand. We can see no justification for continuing with two different basic definitions of business tenancies.

6.2 The 1927 definition is narrower than that in the 1954 Act. The latter contains a comprehensive definition of "business" in Section 23(2). It includes, in addition to the trades and professions within the 1927 Act, an employment, and any activity carried on by a corporate or unincorporated body of persons, such as a limited company or a partnership, although the definition does not extend to other activities carried on by an individual. The term "activity" is wide enough to cover something which is not strictly a trade, profession or employment, such as the activity of a member's

club.[1]

6.3 Adoption of the wide basic definition of "business" contained in the 1954 Act for compensation purposes would, we think, avoid some unnecessary confusion. It would bring more tenancies within the compensation provisions because it would cover premises on which any activity was carried out by a company or other body of persons.

6.4 It does not follow that the specific exclusions from the general class of eligible tenancies must be the same for both purposes. Examples of present differences are: tenants of public houses can claim compensation for improvements but not security of tenure,[2] and tenants carrying on the business of residential subletting can never claim compensation for

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[1] Addiscombe Garden Estates Ltd. v. Crabbe [1958] 1 Q.B. 513, but an "activity" for this purpose must be something that is correlative to the conceptions involved in the words "trade, profession or employment", so that use of premises for storing building waste from other premises was held not to be an occupation for the purposes of tenant's business; see Hillil Property and Investment Co. Ltd. v. Naraine Pharmacy Ltd. (1979) 39 P. & C.R. 67.

[2] Landlord and Tenant Act 1954, s. 43(1)(d).

improvements[3] but may have security of tenure. Tenancies at will, short tenancies and tenancies where the court has authorised contracting out,[4] are excluded from the 1954 provisions but not from the 1927 Act. A further difference is that a tenant cannot usually qualify for security of tenure by using the premises for business purposes in breach of a prohibition against business user,[5] whereas compensation rights do not appear to be restricted to tenants whose business user is in accordance with the terms of their tenancy.

6.5 Our inclination would be to make the categories affected by the 1927 Act the same as those in the 1954 Act, because the later Act is more widely used and its terms are more familiar. In each particular case, there may however be different reasons for and against such a change. We should be interested to have the views of those likely to be affected.

(a) On-licensed premises are presumably excluded from the security provisions to ensure the satisfactory conduct of a business in which, where it is a tied house, the landlord has a closer than usual connection. This has

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[3] Landlord and Tenant Act 1927, s. 17(3).

[4] Landlord and Tenant Act 1954, s. 38(4), added by the Law of Property Act 1969, and see Hagee (London) Ltd. v. A.B. Erikson and Larson [1976] Q.B. 209.

[5] Landlord and Tenant Act 1954, s. 23(4).

no relevance to the question whether the tenant should receive compensation for his improvements to the premises. There is some evidence that the compensation scheme is used in licensed premises.[6] Would there be any justification for excluding them?

(b) Conversely, use of premises for a business of residential subletting can never qualify the tenant to claim compensation for improvements, although in some circumstances the tenant can claim security of tenure. The only possible justification which we can find for preventing claims for compensation is that premises used for residential purposes are in general treated differently from those with purely commercial use,[7] and we have provisionally recommended that this should continue. We suggest that this is a case where the 1927 Act could be made to accord with the 1954 Act, which would provide compensation in a limited number of cases where it is now excluded.

(c) Excluding very short terms[8] from the 1954 Act allows premises to be used on a temporary basis pending proposed demolition, redevelopment or sale. A tenant may be unwise to undertake improvement in those circumstances. There is no reason to deprive him of compensation rights if his apparent improvement does

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[6] From our preliminary investigation, see para. 1.12 above.

[7] See para. 3.1 et seq. above.

[8] Landlord and Tenant Act 1954, s. 43(3).

benefit the landlord. A landlord who in fact redevelops will not have to make any payment. Similarly, the fact that a court has authorised contracting out of security of tenure[9] seems to have no bearing on the appropriateness of compensation.

(d) A tenant whose business user is contrary to the terms of his tenancy is not disqualified from claiming compensation.[10] The 1954 Act excludes security of tenure if the business use breaches a prohibition, unless the landlord has consented or, sometimes, acquiesced. It distinguishes between acquiescence by the current landlord, which has the same effect as consent, and acquiescence by a predecessor, which has no effect.[11] It seems unfortunate for a statute to award compensation to a tenant in breach of his agreement. This is probably a case where the compensation scheme would adopt the 1954 Act rules, permitting compensation if the tenant qualifies for a renewal of his tenancy.

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[9] Ibid. s. 38(4).

[10] His notice of intention to improve may alert the landlord to the unlawfulness of the user and the effect of allowing that use to continue.

[11] Bell v. Alfred Franks & Bartlett Co. Ltd. [1980] 1 W.L.R. 340.

Mining leases

6.6 Tenants under mining leases do not enjoy security of tenure under the 1954 Act, but they do have a very limited form of security. The minister[12] or the court can confer on an applicant new rights to search for or work minerals if satisfied that the grant is expedient in the national interest.[13] Mining tenants enjoy no rights of compensation for improvements. The total exclusion of mining leases from all statutory compensation for improvements is probably justified by the very special nature of mining leases. Above all, mineral rights must always be wasting assets. This means that any improvement in extracting plant or facilities may increase the immediate returns[14] for both the operator and the owner, but if it does so it must also diminish the residual resource.

Recreational and other tenancies

6.7 There are lettings under which the tenant does not occupy for the purposes of a business and so could not qualify for compensation for improvements. But if the letting is to a

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[12] The Secretary of State for Industry.

[13] See the Mines (Working Facilities and Support) Act 1966.

[14] By accelerating the payment of royalties, which are likely to be fixed at rates appropriate to particular minerals rather than to particular mines. Mines, unlike other industrial premises, are not usually let at fixed rents, and letting value is therefore not an appropriate method of valuation.

group of individuals their activity[15] comes within the wide definition of business, and qualifies them for the protection of the 1954 Act. Examples are: lettings for leisure purposes, such as tennis courts, a field for grazing children's ponies, or a site for a holiday caravan. Tenants can make useful improvements in such cases and landlords can consequently have unexpected benefits. We see no justification, or call, for any widespread extension to the compensation scheme but would support the modest extension which would result from adopting the 1954 Act definition of "business".

Provisional conclusions

6.8 Our provisional view is that the comprehensive definition of "business" now used in the 1954 Act should be adopted for the purpose of defining the business tenancies under which tenants may claim compensation for improvements. We also recommend that in three cases the 1927 Act be made to correspond with the 1954 Act. Residential subletting and non-commercial activities by bodies of persons should in future qualify for compensation - which would modestly extend the scheme - and tenants who use their premises for business in contravention of their lease terms should not - which would be a restriction of it.

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[15] See para. 6.2 above.

B QUALIFYING IMPROVEMENTS

No definition of improvements

6.9 The 1927 Act contains no definition of a relevant tenant's "improvements". However, the context almost always indicates what is included. Thus, where the statutory context requires a valuation in rental[16] or capital[17] terms, an improvement is something done by the tenant which affects[18] the letting or capital value, as the case may be. Where the reasonableness of refusing consent is in issue, an improvement is something which the tenant wishes to do and will enhance the tenant's own enjoyment without necessarily affecting either the letting or the residual value of the premises.[19] It is expressly recognised[20] that an improvement may be something which has an adverse effect on the value of the holding. The lack of a precise and detailed definition appears to cause no difficulty. There are, however, some particular issues to consider.

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[16] I.e. for fixing rent under s. 34 of the 1954 Act.

[17] I.e. for assessing compensation.

[18] Usually it is something which enhances value, but s. 34 would also call for the adverse effect of a tenant's improvement to be disregarded.

[19] The meaning of improvement in this context was explained in Lambert v. F.W. Woolworth & Co. Ltd. (No. 2) [1938] Ch. 883, but is not always readily understood.

[20] I.e. in s. 19(2) of the 1927 Act, indicating that the landlord may require reinstatement or payment in respect of damage or diminution in the value of the premises caused by an "improvement".

Incorporeal improvements

6.10 We can detect only one existing area of doubt whether an increase in the holding's value, attributable to the tenant's efforts, can be an improvement qualifying for compensation. That is an enhancement which is not attributable to physical works on the demised premises but to other efforts, such as the tenant obtaining planning consent for a more lucrative use.[21] We believe that the present wording probably does not cover incorporeal improvements,[22] but it should. The tenant's effort and expenditure may be considerable. The landlord may benefit just as much from incorporeal improvements, such as a neighbour's releasing an adverse restrictive covenant or granting a beneficial easement.

6.11 If the definition of improvements is extended, landlords may find that the provision makes it lawful for their tenants to undertake ventures which could previously be absolutely prohibited or made conditional on a landlord's consent or participation.[23] That would be the effect of bringing incorporeal improvements within the provisions of the

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[21] See para. 2.13 above.

[22] See para. 2.13 above..

[23] If our conclusion in para. 2.13 above is correct, a covenant not to apply for any planning consent, or not to do so without the landlord's approval, would be fully effective. It would be desirable that s. 19(2) should also be expressed to apply to incorporeal improvements, so that confusion is minimised.

1927 Act.[24] Another possible difficulty is that a direct cause or relationship between the tenant's effort or expenditure and the improvement may be less easy to establish if the improvement cannot be physically inspected. This however is an evidential problem rather than a point of principle.

6.12 As we can see no distinction in principle, our tentative conclusion is that compensation should be payable for incorporeal improvements. To implement that recommendation, it will be desirable and necessary to limit the extension. It should cover improvements which create or enhance rights recognised by law and which the tenant of the demised premises enjoys in that capacity. Otherwise the door would be opened to bizarre claims, for example that a landlord should pay for the benefit of an upsurge in values, attributable to his tenant's prestigious redevelopments next door.

6.13 Another such increase in value derives from goodwill. Although goodwill might be regarded as something which adds to the value of the holding and is attributable to the tenant's

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[24] We recommend retention of a special authorisation procedure, see para. 5.4 above. It would be possible, but highly inconvenient to include incorporeal improvements in the compensation provisions while continuing to exclude them from the authorisation procedure.

efforts, i.e. an incorporeal improvement, it would not be appropriate to impose a duty to pay compensation for it. It does not derive from the tenant's efforts as a tenant with a property interest, but rather from his occupation and business. Moreover, the 1954 Act includes special provisions in relation to goodwill, notably giving a displaced tenant the chance to claim compensation for disturbance (based on rateable value, to avoid the difficulty of valuing goodwill).

Improvements on land not included in the letting

6.14 A tenant may enhance the value of the demised premises by making physical improvement on other land of which he owns the freehold or a lease or over which he enjoys incorporeal rights, such as a right of way. In some instances this category may merge with incorporeal improvements, e.g. when the tenant secures the grant of a right of way and resurfaces the land. As the land is not part of the demised premises, it seems unlikely that improvements to it qualify for compensation.[25]

6.15 Superficially, it may seem that there is no reason in principle to exclude improvements on other premises from the compensation scheme. When the lease ends, the tenant no longer has the benefit of the improvement, at least so far as it relates to that property. However, the situation is fundamentally different: the end of the lease does not in this case deprive the tenant of the improvement, because, by

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[25] See para. 2.12 above.

definition, it has not been carried out on the property he gives up. There could also be valuation difficulties. If one improvement, perhaps on the tenant's own land, enhances the value of a number of other neighbouring properties held on different leases, a claim might arise at the end of each of those leases. The present valuation formula ensures that the tenant does not make a "profit" from compensation, because it deals with the position of one landlord. If there were a series of different valuations, possibly at different times, this might no longer be the case.

6.16 We are persuaded that these difficulties make this extension of the compensation scheme undesirable, and we do not see that justice demands any extension. If a tenant carries out the improvement on his own freehold property, then he is not deprived of it, even though the landlord's property may benefit. If he improves other land belonging to the landlord, or to some other owner, he still has the chance of compensation at the end of the lease of that other land. For these reasons, we do not recommend any extension of compensation to improvements carried out on other property.

Unlawful improvements

6.17 Compensation is at present payable whether or not the terms of the tenancy would have prohibited a particular improvement. All that the tenant who makes the improvement needs to do is to follow the preliminary procedure laid down by the Act; the improvement is then "lawful" between the

landlord and the tenant. If, as we suggest elsewhere,[26] the preliminary procedure is dispensed with, it becomes necessary to consider whether compensation should be payable for an improvement which the tenant makes in contravention of the terms of the tenancy. It may be unlawful because it is in breach of an absolute prohibition, or the tenant has not requested consent or observed some other preliminary formality. As we have commented before,[27] to compensate a tenant who is in breach of his lease seems perverse. Our provisional view is that improvements made unlawfully should be excluded from compensation unless there has been consent or waiver. We anticipate however that a simple exclusion could be used to contract out of the statutory provisions. In particular, a landlord learning of an unlawful improvement may be willing to agree to it only if the tenant waives compensation rights. We consider elsewhere whether, and how far, contracting out should be permitted.[28]

Other improvements excluded from compensation

6.18 The exclusion from compensation of improvements which tenants are obliged to make under contracts for valuable consideration may go too far in two respects. First, it covers the case of a contract to which the landlord is not a

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[26] See Part V above.
[27] See para. 6.5 above.
[28] See para. 6.43 et seq. below.

party and under which he provides no consideration. Secondly, the landlord may apparently avoid all compensation liability by taking a covenant to oblige the tenant to carry out all proposed improvements.

6.19 The exclusion covers perfectly proper arrangements, e.g. where the lease is granted on the basis that the tenant will carry out improvements in consideration of a rent free period. We can see no reason to narrow down the exclusion to apply only to contracts where the landlord provides the consideration. The result of not paying compensation can be a gratuitous benefit to the landlord; but equally, if he did pay, the tenant would be paid twice, once under the contract and once by the compensation. Whether landlords should be able to use the exclusion to contract out is a more difficult question considered elsewhere in this paper.[29]

Fixtures

6.20 There is one category of tenants' improvements which is specifically excluded from the compensation but is not excluded from either the rent disregard provisions of the 1954 Act or the effect of section 19(2). That is the category of trade and other fixtures which the tenant is by law entitled to remove. The distinction is logical. The fixtures can be removed at the end of the tenancy, so the tenant is never obliged to present the landlord with the benefit of their residual value.

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[29] See para. 6.43 et seq. below.

Detrimental improvements

6.21 It seems to stretch the meaning of the word to breaking point to talk of a detrimental "improvement". However, it will be accepted that changes to a property can reduce its market value. The notion is already apparent in section 19(2) of the 1927 Act in relation to the reasonableness of a landlord's refusal to consent to a tenant's improvements.[30] For instance, the tenant may modify the structure so that he can make better use of the demised premises in conjunction with adjoining premises of his own, but so that neither he nor anyone else could use the premises as an independent unit without carrying out expensive works of reinstatement. There is clearly no question of compensating a tenant who makes a detrimental improvement. The question is whether compensation for tenants should be mirrored by compensation for landlords.

6.22 Long before 1927, the common law had protected landlords against the effect of detrimental alterations made by tenants. Leases could absolutely prohibit improvements, and landlords could arbitrarily withhold consent, or consent subject to reinstatement conditions. In addition, the doctrine of waste normally confers adequate protection. Every

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[30] Which does not preclude the landlord's right to require as a condition of consent the payment of a reasonable sum in respect of any damage to, or diminution in, the value of the premises.

tenant has an obligation not to commit waste:[31] the landlord can recover damages when the tenant's alterations diminish the value of the premises. We would like to hear from landlords whether there is a case for statutory compensation because landlord's claims are not adequately met by the doctrine of waste.

6.23 The landlord may sometimes lose the protection of the doctrine of waste, and of the lease covenants. If the court certifies an improvement as a proper one, the 1927 Act says it is "lawful" for the tenant to proceed. To obtain that certificate, the tenant has only to satisfy the court that the proposed improvement is calculated to add to the letting value at the end of the tenancy, not to guarantee that it will do so. Presumably the tenant's "lawful" action cannot amount to waste, even if his action proves adverse in the long term. Likewise if a court finds that the landlord withheld consent unreasonably, he may not be able to allege that the execution of the tenant's proposal was unlawful, even if he then suffers damage.

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[31] The extent of the obligation depends on the nature of the tenancy. For summaries of the relevant principles, see Woodfall's Law of Landlord and Tenant 28th ed., 1-1513 to 1-1532, and Hill and Redman's Law of Landlord and Tenant 17th ed., (1982), pp. 213-219.

6.24 Our provisional view is that a landlord who finds the value of his property diminished by a business tenant's "improvements" should be eligible to claim compensation. We doubt whether there will be a large number of claims. However, we do think that there may be a significant number of cases in which a landlord could fairly wish to "set off" the adverse effect of one improvement against the compensation he was required to pay in respect of another, beneficial but unrelated improvement.[32] We invite comments from landlords and tenants on the desirability of conferring statutory compensation rights on landlords of business premises.

Who made the improvement and when it was made

6.25 There is no logical reason for distinguishing between improvements which were made by the current tenant and those which were made by his predecessors, or between improvements completed during the current tenancy and those made during previous tenancies, provided that there have been continuous lettings, with each new tenancy granted to the then sitting tenant: an improvement which outlasts tenancy renewals and changes of ownership is just as capable of benefiting the landlord as one whose effect is considered sooner. Premiums paid on successive assignments will presumably reflect the residual value of any improvements, so that the tenant claiming compensation will almost always have paid something for those improvements, either directly or indirectly.

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[32] For a fuller discussion see para. 6.39 below.

6.26 Some of the changes made in 1954 and 1969[33] to the rights of business tenants make it the more desirable that compensation rights should be carried over from one tenancy to the next as well as from one tenant to the next. Now that security of tenure is the norm, it is an encouragement to tenants to make more lasting improvements. It seems illogical that limitations in the compensation scheme should detract from that encouragement. We consider that compensation rights could be rolled over from one tenancy to the next on the same conditions as regulate the ignoring of the effect of improvements when the rent under a new business tenancy is fixed.

6.27 Two simple conditions, equally appropriate in both applications, are:

(i) that there shall not have been an intermediate quitting by the claiming tenant or his predecessor (in which case a claim for compensation may have been made then, and the new tenancy will be a tenancy of the premises in their improved state);[34] and

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[33] I.e. Part II of the Landlord and Tenant Act 1954, amended by the Law of Property Act 1969.

[34] Landlord and Tenant Act 1954 (as amended), s. 34(2)(c). See also Brett v. Brett Essex Golf Club Ltd. (1986) 278 E.G. 1476, (C.A.), where it was held that work done by a tenant during a previous, surrendered lease formed part of the demised premises under a new lease, and could not therefore qualify as an improvement whose effect was to be disregarded on a rent review in the new lease.

(ii) that if the improvement was made during an earlier tenancy, it shall not have been completed more than twenty-one years before the application.[35]

C. THE MEASURE OF COMPENSATION

The present measure

6.28 The present measure of compensation requires the landlord to pay for the benefit which he actually gets from the improvement. This will usually be the capital sum representing the increase in letting value attributable to the improvement, but it may be less. The landlord's liability will be reduced if he could make an equivalent improvement at a cost lower than the resulting increase in value. It will also be reduced or excluded if he is not going to enjoy the full benefit of the improvement, e.g. because it will be inappropriate to the proposed new use of the holding, or because the premises are to be demolished.

6.29 It may well be that a measure based on the value of benefit to the landlord is still the fairest and most appropriate measure. We recognise, however, that in some circumstances tenants may be aggrieved: when their landlords discard improvements which still have residual value; and when there has not been time for a discarded but recent improvement to bring in appreciable trade returns. Nevertheless, other measures may offer some advantages, even though they may be

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[35] Landlord and Tenant Act 1954, s. 34(2)(a).

seen to penalise landlords, and we have therefore very briefly outlined some other approaches which may be considered.

Amortisation

6.30 One possible modification is to take into account the tenant's enjoyment of the improvement. It should not be forgotten that his motive for improving the premises was not to enhance their residual value, but to enhance his own enjoyment and probably his trade returns. He will only undertake an improvement which is calculated to pay for itself within a reasonably short time, so as to justify the investment of capital. That will be reflected in his accounts. The idea of introducing a discount to reflect the tenant's enjoyment and/or amortisation is initially attractive. However, any discount system would be difficult to operate in practice, in part because of the difficulty in fixing the appropriate period of amortisation, especially if there have been multiple and staged improvements. Also, the tenant's accounting policy may well be influenced by fiscal considerations. We therefore reject the suggestion, which would add to the complexity of the system without manifestly increasing its fairness.

The tenant's loss

6.31 The whole basis of the compensation measure could be changed, so that compensation related to the tenant's loss. That would remove a tenant's fear that his landlord's plans

for the future of the premises will both deprive him of the premises and defeat a compensation claim. The loss could be measured either in terms of the tenant's actual outlay, or in terms of the benefit which he could have enjoyed from the improvement if his tenancy had continued.

6.32 If the tenant's actual expenditure were the basis, there would have to be adjustments to take into account his actual enjoyment, the prudence and reasonableness of his expenditure, and inflation. The computations could rapidly become contentious and complicated. This possibility seems to us to have little to recommend it.

6.33 A subjective measure, of the improvement's value to the particular tenant who leaves it behind, also seems to us to lack merit. Landlords could then be forced to pay for modifications which they were unable to use and for which no other tenant would be willing to pay, which few would see as just.

6.34 An objective measure, based on the improvement's value in the open market, would be the equivalent of the present formula, without the chance of reduction or cancellation as a result of the landlord's actions. It would discourage landlords from wasting valuable assets created by their tenants. It would further the general aim of encouraging the improvement of commercial property. All the same, that measure could be seen as an unjustified fetter on the landlord's freedom to manage his premises beyond the term of

the tenancy. The landlord could be discouraged from redeveloping or carrying out his own improvements. It therefore encourages some improvements only to discourage others. We do not see that this offers any major benefit.

6.35 Although it is proper to examine alternatives to the present method of valuation, we see no case for change. We know of no case in which a tenant has been deterred from improving premises because he considered the likely amount of compensation inadequate. We provisionally conclude that the present measure of compensation should be continued.

Consistency with other statutory provisions

6.36 Valuations of the same improvement may be needed for two different statutory purposes, i.e. to compensate the tenant,[36] and to avoid charging him rent on his own investment.[37] To simplify the law it would be advantageous to remove any inessential differences between the two valuations.

6.37 It is true that compensation requires a capital valuation and rental requires an income valuation, but the former can be a capitalised form of the latter. However, it is not practicable to tie the two valuations irrevocably together, because under section 34 of the 1954 Act:

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[36] Under Part I of the Landlord and Tenant Act 1927.

[37] In the terms of a new tenancy granted under Part II of the Landlord and Tenant Act 1954.

(i) the improvement is valued in rental terms over, at most, the period for which the new lease is granted, (which may fall far short of the improvement's anticipated useful life), and on the other terms and conditions fixed by the court or agreed (which may not yield the best possible rent for the improved premises);

(ii) the rental fixing is based on estimates as to how rental values may fluctuate during the term, which estimates may have been proved fallacious by the time compensation is payable; and

(iii) the current cost may be a fair ceiling in terms of compensation (because the landlord who pays current cost is not unjustly enriched), but could not be relevant in assessing any rental value. The current market rental value of improved premises, and the proportion of that attributable to the improvement, bear no relation to the current cost of making the improvement and should not be deemed to do so.

For these reasons, we consider that a reconciliation is inpracticable.

Dealing with hard cases

6.38 No single measure of compensation can produce a fair result in every case, so the temptation is to make special provisions for hard cases. It would be possible to use

different measures according to the circumstances, e.g. so that the landlord could not rely upon his proposed change of user to reduce the claim if he had consented to the improvement and/or was claiming possession so that he could redevelop.[38] However, it would be undesirable and confusing to have more than one measure of compensation operative under the Act, and we doubt whether the duplication could, in any event, achieve universal fairness. An alternative way to ameliorate apparent injustice would be to give the court a discretion to depart from the normal measure where satisifed that it would not do justice between the parties. If the discretion was absolute, it would allow the court to award whatever measure of compensation it thought fit. This has the advantage that flexibility can yield fairer individual results. Its inevitable disadvantage is that there will be greater uncertainty. Any such discretion would inevitably attract unmeritorious applications as well as deserving ones, and the inherent uncertainty would be much too high a price to pay. We cannot therefore recommend it.

Compensation for landlords

6.39 The measure of damages in an action for waste is the diminution in the value of the reversion,[39] which is related to rental return and is not necessarily the sum which it would

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[38] But under such a rule, landlords could become the victims of vagaries in the planning system, e.g. if a landlord consents to a tenant's improvement at a time when there seems to be no prospect of planning permission for his own other proposals, but planning permission is ultimately granted.

[39] Whitham v. Kershaw (1885) 16 Q.B.D. 613.

cost to restore the property to its condition before the waste. There is a case for saying that where a detrimental improvement has been forced on the landlord, he should be entitled by way of compensation to the cost of restoration, if that is greater than the diminution. He should be entitled to put himself and his property in the same position as they would have been if the detrimental works had not been authorised. It can be argued that this is not merely financial loss, because every property is unique and a landlord should not be obliged to take back his property altered in a way he did not want. That is one argument in favour of awarding statutory compensation to landlords faced with detrimental "improvements" rather than merely preserving the remedy in waste. But the idea goes against the general rule, which is to limit damages or compensation to a difference between values when that difference is less than the cost of putting things right.[40] Further, a landlord whose property is beneficially improved, and who pays rather than receives compensation, is obliged to accept the improvement. We are not convinced by the case for departing from the general rule, and recommend that the measure of compensation for the landlord be whichever is the less of the reduction of value of the reversion and the cost of reinstatement.

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[40] See e.g. Landlord and Tenant Act 1927, s. 18(1), and Perry v. Sidney Phillips & Son [1982] 1 W.L.R. 1297.

Deductions

6.40 The court is expressly directed to take into consideration, in reduction of the tenant's claim, any benefits which the tenant or his predecessors in title may have received from the landlord or his predecessors in title in consideration expressly or impliedly of the improvement.[41] That direction would, no doubt, cover benefits given by agreement between the landlord and tenant, before or after the improvement was made, although the effect of section 9[42] may be that benefits are not valued exactly in accordance with the parties' agreement.[43] The direction would also cover contributions which the landlord may have been ordered to pay when the tenant made an improvement pursuant to a statutory obligation.[44]

6.41 It may be thought that deductions should also be made when all or some of the cost of the improvement has been provided from other sources. It might be difficult to justify

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[41] S. 2(3).

[42] See para. 2.34 above.

[43] E.g., if the tenant has accepted a small sum in lieu of his statutory rights. The Act does not specify how such benefits should be valued. We doubt whether it would be feasible to lay down rigid valuation rules here. The present flexibility appears to be satisfactory.

[44] Before the 1954 amendments such improvements were excluded from compensation.

bringing private benefits[45] into account, for instance, ex gratia financial contributions from a parent, or parent company, but there is a case for restricting private compensation rights when some part of the original cost has been met out of public funds. Then, private compensation rights are not needed either as an inducement for the improvement to be made, or to avoid the injustice of landlord enrichment at the tenant's expense. Instead, private compensation becomes a windfall for a tenant who has made his improvement at somebody else's expense.

6.42 However, we think that for several reasons it is impracticable to direct that such benefit be taken into account. Assistance from public funds can take many different forms, not all as easy to value as the direct cash payment of a grant. Also, assistance is provided for a variety of purposes, which could be jeopardised by a rule that all benefits received must be taken into account. For instance, an especially generous grant may be designed to induce occupiers to include a particular feature of improvement. The purpose would be defeated if the compensation from the

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[45] Otherwise than as part of a contract under which the tenant receives consideration for making the improvement, which is thereby excluded from the provisions altogether.

landlord had to be reduced by the amount of the grant.[46] It seems to us preferable that when some form of assistance (other than compensation) is made available to the tenant, the effect should be regarded as cumulative unless the intention of the legislation providing the assistance is clearly otherwise. If the legislation directs that assistance should go to the landlord, or to the tenant, as the case may be, it is not for the tenant and landlord to reallocate the benefit.

D CONTRACTING OUT

Present restrictions

6.43 There are two provisions in Part I aimed against contracting out. section 3(4) provides that where there has been certification of, or no objection to a proposed improvement, it shall be lawful for the tenant to execute it, notwithstanding anything in the lease to the contrary. Section 3 is, however, silent as to the validity of any contract seeking to undermine the statutory authority, e.g. by requiring reinstatement of the premises to their former state during or at the end of the tenancy.

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[46] C.f. Palatine Graphic Arts Co. Ltd. v. Liverpool City Council [1986] Q.B. 335 where it was held that a regional development grant, designed to induce relocation in a development area, should not be deducted from the compensation for disturbance payable on compulsory acquisition.

6.44 Section 9 is in more sweeping terms. It provides that Part I (which includes section 3) shall apply notwithstanding any contract to the contrary. But section 9 is also silent as to the validity of contracts designed to affect the application of Part I. It seems that a carefully drawn lease can, prima facie, guarantee that no permanent improvements are made, and that compensation is never payable. As compensation is not payable for an improvement which the tenant is contractually obliged to carry out, the landlord can probably avoid liability by taking a covenant that the tenant must carry out any improvement which he proposes and the landlord approves. Alternatively, a tenant's covenant to reinstate at some stage after completion of the alterations can be used to ensure that at the end of the day there is no improvement which can form the basis of a compensation claim.

Effectiveness of present restrictions

6.45 This form of contractual side-stepping does not offend against a literal construction of the words of the Act, although clearly designed to defeat the statutory objectives. That is obviously unsatisfactory. Whether contracting out, or avoiding the effect of the Act, ought to be prevented is a different question.

Whether contracting out should be permitted

6.46 If contracting out of Part I were freely permitted, the purpose of the legislation would be defeated. The Act is

not intended to provide an optional compensation scheme[47] and the purpose of the authorisation procedure is to allow improvements which are contractually prohibited. Both the authorisation and the compensation functions depend on the inability of the parties to contract out prospectively by providing in the lease (expressly or not) for the exclusion of the effect of Part I. Section 9 in its present form does not appear adequately to perform this function.

6.47 It does not follow that contracting out which is not prospective should also be prohibited. There is no obvious reason why the parties should be prevented from substituting their own arrangements for the statutory machinery, in respect of a particular improvement which has been proposed. The bargaining positions of the parties should at that point be equal because, if they do not agree special terms for a particular improvement, the statutory provisions will apply. We therefore see no reason to require that contracts modifying the application of the Act in relation to a specified improvement would be subject to any test of reasonableness, be for adequate consideration, or be approved by the court on any other basis.

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[47] E.g. the introduction of what was in effect an optional scheme for agricultural improvements, in 1875, which was a conspicuous failure.

Further restrictions

6.48 Section 9 needs to be stronger to prevent indirect contracting out of a prospective nature. An agreement negotiated in advance, in respect of a specified improvement only, would stand, but attempts to contract out of liability to pay compensation or to restrict its amount for all improvements, as yet unspecified, would fail. This would have to apply to the original tenancy agreement and any modifications of it relating to potentially qualifying improvements. It must be drawn so that it will not attach to other continuing obligations of the tenant, such as a repairing obligation, where performance may have the incidental effect of enhancing the value of the premises.

6.49 Reinstatement covenants could be dealt with in the same way. No control need affect a reinstatement obligation imposed in exchange for consent to a specific improvement.[48] The provisions to be made void would be terms of a lease or collateral agreement requiring the tenant generally and in respect of unspecified future improvements, to restore the demised premises to their original state or condition, or to do anything calculated to diminish the letting value attributable to the improvement.

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[48] Where the tenant has an opportunity to challenge the reasonableness of the condition when the landlord seeks to impose it.

Transitional provisions

6.50 In line with the general reluctance to change bargains retrospectively, it is arguable that our suggestions for tightening up the provisions against contracting out ought not to apply to existing leases. However, direct contracting out is already expressly prohibited, and the spirit of the legislation is clear. Our recommendations go no further than enforcing the spirit of the existing legislation and, in our view, landlords will not be unfairly prejudiced by applying them to leases already granted, although not to improvements which have already been completed. Dealing only with future improvements prevents landlords having to pay compensation unexpectedly in cases where they have already taken steps to ensure they would not have to do so.

E MAKING A CLAIM

Time for making application

6.51 It seems to us sensible that the first step in making the claim at the end of the tenancy should be a written application to the landlord, followed up by an application to the court only if the parties fail to reach agreement. The existing procedure at this stage is straightforward and we see no need to change it. The rules governing the time at which the application must be lodged are, on the other hand, far

from straightforward.[49] The rules are unsatisfactory in relation to tenancies terminated by notice. The contractual terms may require, or the terminating party may give, notice far exceeding three months. The tenant is then forced to lodge his compensation claim well before the time he actually quits. If he fails to do so, he forfeits any right to compensation, even though the landlord would not be prejudiced by a later application. The security of tenure provisions exaggerate this effect. The minimum effective notice period is six months. In practice, the period is often extended while the parties negotiate and the tenant's application for a new tenancy is pending. The tenancy will not be terminated (except by agreement or a new grant) less than three months from final determination or withdrawal of the tenant's application. By then, the lodging of the compensation claim may be a historical event based on out of date figures.[50] Moreover, if a new tenancy is granted, the costs of the application for compensation will be thrown away.

6.52 There are two possible solutions. One is to provide that where a notice ends the tenancy, the application must be lodged within the final three months of the effective notice period. This will usually, but not necessarily, be the three months following the final determination of the tenant's application for a new tenancy. The period could occasionally

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[49] See para. 2.30 above.

[50] Rules of court currently require that the amount claimed is specified in the claim.

run beyond the termination date, e.g. in a periodic tenancy of on-licensed premises which attracts no statutory security of tenure and may therefore be effectively determined by a contractual notice to quit of less than three months. The other existing timing requirements would remain unaltered.

6.53 A simpler alternative is to provide that an application must be lodged within, say, three months after actual termination whatever the cause of termination. One clear advantage is that the tenants would be better able to assess the chances of a claim once the landlord's intentions for the future of the property have matured. A second advantage is that tenants could always defer preparing their applications until it was certain that they must leave the premises. Landlords would only be prejudiced by later applications if their post-termination plans could be influenced by a compensation claim, but it seems unlikely that they would elect for change of use or redevelopment solely to deprive a tenant of compensation.

6.54 A practical drawback to the simpler alternative is that in the absence of any limit at all on how early valid claims could be lodged, tenants might be encouraged to lodge their claims long before it could be known whether there was any chance of success, and before any realistic valuations could be made. Indeed, they might try to safeguard themselves by putting in "holding" claims as soon as the improvements were made, which is not at all desirable. Manifestly premature applications would, we suggest, have to be

discouraged. There could be a rule that an application could not be made before the tenancy ends. Or, a claim could cease to be effective after (say) three months, unless an application had been made to the tribunal within that period; the tribunal's procedural rules could provide for an application to be struck out at any time before the tenancy came to an end if the effective termination date was not then known.[51]

6.55 We favour the adoption of the simpler alternative, because it will clarify the rules about claiming compensation and will introduce an easily understood principle. For this reason also, we favour a clear-cut rule not only for the final date upon which a claim may be made, but also for the earliest date. We should welcome views on the acceptability of a rule that all compensation claims should be made during the three months following the determination of the tenancy, and neither earlier nor later.

The tribunal

6.56 The tribunal for the determination of all questions as

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[51] That would prevent applications which could not be dealt with from being left lying on the record until the relevant date was ascertained. An application would not be struck out for uncertainty on the ground that although the tenancy was due to end on a date within the period, it might determine prematurely.

to the right or amount of compensation is the court.[52] Disputes as to the amount payable are likely to outnumber those about entitlement, so the possibility of transferring jurisdiction to the Lands Tribunal should be considered.

6.57 Hearings before the Lands Tribunal could be shorter because of the specialist experience of its members, with a consequent saving in costs. Parties before the Tribunal can be represented by counsel, solicitors, or any other person with the leave of the Tribunal, which has a wide discretion in awarding costs.[53] We understand that, in practice, costs are usually awarded on either the High Court or county court scale, as seems appropriate in the circumstances. An argument against transfer is that although Lands Tribunal hearings can be held anywhere in England or Wales, all the administration takes place in London, whereas both the High Court and county court have local offices where litigants can attend with personal queries. We would be interested to hear from those concerned whether they favour a transfer of jurisdiction to the Lands Tribunal.

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[52] The county court has jurisdiction where the rateable value of the holding is not over the county court limit. Applications in the High Court are assigned to the Chancery Division; R.S.C. O. 97, r. 2.

[53] Lands Tribunal Rules 1975, SI 1975/299, r.56.

PART VII

SUMMARY OF PROVISIONAL CONCLUSIONS

7.1 We set out below a summary of our provisional views and recommendations on the main points arising in the study. Our intention is to review the subject of compensation after interested parties have had the opportunity to consider the subject in general and our provisional conclusions in particular. We shall be grateful to receive comments and criticisms from landlords and tenants, professional advisers and any others concerned with property matters. We would like to hear from those who disagree with our provisional recommendations as well as from those in agreement, and we are anxious to know what basic and detailed reforms people who are in favour of retaining or extending the scheme of compensation would like to see.

The need for compensation

7.2 There should be no general statutory right for residential tenants to claim compensation from their landlords (paragraph 3.5).

7.3 The present scheme of statutory compensation for business tenants should continue, subject to reconsideration of its details (paragraph 3.13).

A revised authorisation procedure

7.4 A tenant should be required to give notice to the landlord before making an improvement if he wishes later to make a compensation claim. The requirement would be satisfied by the tenant's request for consent under the terms of the lease, or by bare notification (paragraph 5.22).

7.5 A landlord's refusal of consent to a proposed improvement should be treated as reasonable if he has undertaken an obligation to carry out that improvement, whether or not in return for an appropriate rent increase (paragraph 5.24).

Transitional provisions

7.6 Improvements made before abolition of the special preliminary procedure should qualify for compensation only if that procedure has been followed (paragraph 5.26).

Tenancies under which compensation is payable

7.7 The basic, wide definition of tenancies to which Part II of the Landlord and Tenant Act 1954 (security of tenure for business, professional and other tenants) applies, should be used to define the business tenancies whose tenants may qualify for compensation when they quit after making improvements (paragraphs 6.3, 6.8).

7.8 The scheme should nevertheless continue to apply to: (a) tenancies of on-licensed premises, and (b) tenancies for short terms, and be extended to tenancies of premises used for residential subletting, but it should not apply where the business user is in breach of the terms of the lease (paragraphs 6.5, 6.8).

Qualifying improvements

7.9 Compensation should be payable for incorporeal improvements which create or enhance rights recognised by law and which the tenant of the demised premises enjoys in that capacity (paragraph 6.12).

7.10 Compensation should not be extended to improvements carried out on other property (paragraph 6.16).

7.11 Compensation should not be payable for improvements made in breach of covenant unless there has been consent or waiver (6.17).

7.12 Compensation should be payable by a tenant to the landlord when the tenant's improvement has diminished the value of the landlord's property (paragraph 6.24). The measure should be whichever is less of the reduction in value of the reversion and the cost of reinstatement (paragraph 6.39).

7.13 Tenants should be entitled to carry over their compensation rights when their tenancies are renewed (paragraph 6.26).

The measure of compensation

7.14 There should be no change to the present method of valuation (paragraph 6.35).

7.15 No deductions should be made in respect of grants or other contributions made by third parties (paragraph 6.42).

Contracting out

7.16 The present provisions against contracting out should be strengthened to prevent indirect contracting out of a prospective nature (paragraph 6.48) and to control the effect of reinstatement obligations imposed primarily to avoid compensation liability (paragraph 6.49).

Making a claim

7.17 Claims should be made during the three months following the determination of the tenancy, and neither earlier nor later (paragraph 6.55).

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